

Martha Stewart's Explanations of Innocence: Securities Fraud or Protected Speech?

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The flood of publicity about the investigation and the prosecution of Martha Stewart, all-purpose public figure, media personality, and authority on all things domestic, runs the risk of obscuring a serious issue at the intersection of the securities laws and the First Amendment. Although Judge Cedarbaum's idiosyncratic decision to close jury selection to the press and the public offends the First Amendment and our national tradition and history of open courts, her error was corrected to discourage other judges from committing similar constitutional errors in the future.¹

The more lasting damage to the First Amendment may result from Count Nine of the indictment against Stewart, which charges that she committed securities fraud when she made and caused her lawyers to make several public statements proclaiming her innocence in June 2002, as she became the subject of a growing number of press reports about the government's investigation into her stock trading activity. This admittedly novel securities fraud theory has been front and center during the criminal trial and in the class action securities cases pending against Stewart.²

In extensive pretrial filings, Stewart and the government joined issue on this unprecedented criminal theory. Armed with the voluminous press clippings from the summer of 2002, Stewart argued that she had a First Amendment right to reply to the false and damaging news reports accusing her of insider trading. Stewart further argued that the government was punishing her for speaking out on issues of public concern and for daring to exercise the constitutional presumption of innocence in public. According to Stewart, the

government had no interest, much less a compelling one, that justified prosecuting her for personal statements she made about personal business dealings not involving her publicly traded company. Under Stewart's theory, if the government has its way, no corporate executive or corporate executive's lawyer can safely deny charges in the future without risking additional charges of securities fraud.

The government argued that Stewart's detailed, repeated statements about her innocence deserved to be chilled and punished. Her statements were false, had no constitutional value, and were the crime of securities fraud itself.

On Stewart's motion to dismiss, Judge Cedarbaum ruled for the government. On motions *in limine*, she ruled further that Stewart's lawyers could not argue any First Amendment defense to the securities fraud charges. The clash between the securities laws and the First Amendment was teed up, but the court averted some further damage to the First Amendment by dismissing the securities fraud charge at the close of the evidence.

Stewart Trades in ImClone Stock Before ImClone Announces Its Bad News³

Although she previously worked as a stockbroker for seven years, Stewart is best known as the CEO and chairman of the publicly traded company, Martha Stewart Living Omnimedia, Inc. (MSLO). During the early 1990s, Stewart became friends with Dr. Sam Waksal, the co-founder of ImClone Systems, Inc., a company that trades on NASDAQ; Stewart purchased a large number of shares of ImClone. ImClone was in the business of developing biologic medicines, and, at the time, its leading product candidate was Erbitux, a biologic treatment for a type of colon cancer. ImClone was seeking U.S. Food and Drug Administration (FDA) approval for Erbitux and, on October 31, 2001, submitted the final substantive portion of its application to the FDA. It was

publicly reported that the FDA was expected to determine by December 31, 2001, whether ImClone's application was administratively and scientifically complete and whether it would be accepted for filing or whether additional information would be required.⁴

In late December 2001, Waksal privately learned that the FDA would not accept ImClone's Erbitux application for filing.⁵ On the morning of December 27, 2001, Waksal and a Waksal family member sent urgent instructions to Peter Bacanovic, their stockbroker at Merrill Lynch & Co., to sell all of their ImClone shares, then valued at over \$7.3 million. Bacanovic was on vacation in Florida, so the Waksals' instructions were received by his assistant, Douglas Faneuil, who promptly relayed them to Bacanovic between 9:00 and 10:00 a.m. ImClone shares owned by the Waksal family member were sold almost immediately for approximately \$2.5 million. Faneuil then spent the rest of the morning talking with Bacanovic and with other Merrill Lynch supervisors to determine whether Waksal could sell his ImClone shares either directly or by transferring them through the family member's account.⁶

Merrill Lynch's internal policies prohibited Bacanovic from discussing the business affairs of one client with another and from entering into "piggyback" transactions to take advantage of the perceived expertise or knowledge of a client, including inside information.⁷ Yet Bacanovic allegedly called Martha Stewart's office at 10:04 a.m. the same day, shortly after hearing of the Waksals' trading instructions, and left a message with her assistant. This message, which Stewart's assistant purportedly memorialized in a computerized phone message log, stated: "Peter Bacanovic thinks ImClone is going to start trading downward." Bacanovic also allegedly told Faneuil to tell Stewart about the Waksals' trading activity if she called back.⁸

Stewart is alleged to have received Bacanovic's message en route to Mexico and called his Merrill Lynch

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office at 1:39 p.m. during a refueling stop. Stewart purportedly spoke with Faneuil, who allegedly told her about the Waksals' trading instructions, and directed Faneuil to sell the 3,928 ImClone shares in her account.⁹ Stewart's trades were executed shortly thereafter, yielding proceeds of approximately \$230,000.¹⁰

After the market closed the following day, December 28, 2001, ImClone announced that the FDA had refused to accept the application for Erbitux. ImClone shares dropped another 18 percent when the market opened on December 31, the next business day. By trading earlier, Stewart avoided losses of over \$45,000.¹¹

The Government Interviews Stewart and Bacanovic

In January 2002, the Securities and Exchange Commission (SEC), the Federal Bureau of Investigation (FBI), and the U.S. Attorney's Office started investigations into trading of ImClone securities prior to the company's public disclosures about the FDA action on the Erbitux application. The regulators quickly focused on the trading activity of the Waksals and Stewart. SEC staff attorneys interviewed Bacanovic by telephone on January 7, 2002, and in person, pursuant to a subpoena and under oath, on February 13, 2002.¹² Representatives of the SEC, the FBI, and the U.S. Attorney's Office interviewed Stewart in person on February 4, 2002, and by telephone on April 10, 2002.¹³ The SEC also sent requests for production to Merrill Lynch and to Martha Stewart.¹⁴

During the interviews, Stewart and Bacanovic both stated that although no formal stop-loss order ever was put in place,¹⁵ they had an understanding that Stewart would sell her ImClone shares if the price fell below sixty dollars per share.¹⁶ Consistent with this understanding, they further stated that Stewart told Bacanovic (not Faneuil) to sell her ImClone stock on December 27, 2001, after the stock dropped below sixty dollars per share. Stewart denied learning that the Waksals were selling their ImClone shares prior to her sale.¹⁷

Stewart and Bacanovic Allegedly Alter Electronic Data and Documents

Before Stewart's February 4 interview, she reviewed the phone message log her assistant maintained on computer and the

phone message Bacanovic left for her on December 27, 2001. Stewart altered the original message, changing it from "Peter Bacanovic thinks ImClone is going to start trading downward" to "Peter Bacanovic re imclone." Shortly after changing the message, Stewart instructed her assistant to return the message to its original wording.¹⁸ During her government interviews, however, Stewart stated that she did not know whether the phone message Bacanovic left her was recorded in the phone message log maintained by her assistant.¹⁹

Bacanovic allegedly altered a worksheet he had prepared during a conversation with Stewart. During his initial interview, Bacanovic testified that he had notes reflecting Stewart's intention to sell ImClone when the stock price fell to sixty dollars per share. Bacanovic stated that, during a telephone conversation with Stewart on December 20, he had prepared a worksheet that listed securities Stewart had agreed to sell before year-end to obtain tax losses. The worksheet showed the market value of each security, Stewart's unrealized profit or loss as of December 20, and Bacanovic's handwritten notes in blue ballpoint ink of planned transactions in Stewart's account. Bacanovic allegedly added the notation "@ 60" to the ImClone entry at a later date, using ink from another blue ballpoint that was "scientifically distinguishable" from the other blue ink on the worksheet. Merrill Lynch sent the altered worksheet to the SEC in February 2002.²⁰

Stewart Publicly Proclaims Her Innocence

Congress became interested in Stewart's and the Waksals' trades and, according to Stewart, began leaking information adverse to Stewart to the media.²¹ After the stock market closed on June 6, 2002, Stewart learned that the Associated Press and the *Wall Street Journal* were publishing articles breaking the news that Stewart sold ImClone shares just before the public announcement of the FDA's rejection of the Erbitux application and on the same day as members of the Waksal family had.

At the time, Stewart owned stock controlling over 94 percent of MSLO shareholders' voting power, and her investment in MSLO was worth hundreds of millions of dollars.²² According to the indictment, Stewart then caused her attorney to provide false and misleading infor-

mation explaining her ImClone trades in order to prop up the share price of MSLO. Specifically, her attorney issued a statement, which was published in the *Wall Street Journal* on June 7. The statement provided in part: "The sale was executed because Ms. Stewart had a predetermined price at which she planned to sell the stock. That determination, made more than a month before the trade, was to sell if the stock ever went less than \$60."²³

On June 12, the news media reported that Sam Waksal had been arrested and charged criminally with insider trading.²⁴ After the close of trading that day, Stewart issued a second public statement in which she reiterated that she had agreed with her broker at a time when ImClone shares were trading at \$70 per share that "if the ImClone stock price were to fall below \$60, we would sell my holdings." Stewart further stated that, on December 27, "I returned a call from my broker advising me that ImClone stock had fallen below \$60 . . . and reiterated my instructions to sell the shares." Finally, Stewart denied having any "improper information" and concluded, "My transaction was entirely lawful."²⁵ The negative press continued, however.

After the stock market closed on June 18, Stewart issued a third public statement, again denying any improprieties in connection with her sale of ImClone stock. She affirmed the accuracy of her June 12 press release, noting that her decision to sell was "based on information that was available to the public that day." Stewart also confirmed that she "did not have any nonpublic information regarding ImClone" at the time of her sale and that her sale was based on an agreement with her broker to sell when the stock fell below sixty dollars per share. Finally, she stated that she was cooperating with authorities "fully and to the best of [her] ability."²⁶ Stewart also read the press release at a conference for securities analysts and investors in MSLO stock the next day, June 19.²⁷

Congressional sources, stock analysts, and the media continued to raise questions concerning Stewart's actions. MSLO's stock price fell steadily from a closing price of \$19.01 on June 6, 2002, to a closing price of \$11.47 on June 28, 2002.²⁸

The Investigation Continues

The government's investigation into ImClone trading continued to gather momentum. On June 20, 2002, Faneuil

began cooperating with the government. Faneuil stated that he, not Bacanovic, had spoken to Stewart on December 27; that he had informed Stewart of the Waksals' trading instructions; and that he did not know of any agreement between Stewart and Bacanovic to sell Stewart's ImClone shares if the stock price dropped below sixty dollars. Faneuil also revealed that Bacanovic had offered him an extra week of vacation and a plane ticket if Faneuil would continue to mislead the government about the events of December 27.²⁹

In October 2002, Faneuil pleaded guilty to a misdemeanor charge of "receiving money or other valuable things as consideration for not informing" the government of violations of the federal securities laws under 18 U.S.C. § 873.³⁰ Merrill Lynch then fired Bacanovic and Faneuil, both of whom had been on paid leave. Faneuil was a principal government witness against Stewart and Bacanovic.

The Government Indicts Stewart and Bacanovic

On June 4, 2003, a New York federal grand jury indicted Stewart and Bacanovic for conspiracy to obstruct justice, to make false statements, and to commit perjury; for making false statements to federal investigators; and for obstruction of justice. The government alleged that Bacanovic and Stewart engaged in a conspiracy to cover up Stewart's improper trading, as evidenced by (a) the alleged understanding that Stewart would sell ImClone shares when they reached sixty dollars per share, (b) the common misstatement that Stewart and Bacanovic spoke on December 27, when Stewart in fact talked only to Faneuil, and (c) the alteration of electronic and paper documents by Stewart and Bacanovic.

Although Stewart was not indicted for insider trading in ImClone stock,³¹ in the last count of the indictment, the government charged Stewart with securities fraud based on her series of public statements in June 2002. Specifically, the government claimed in Count Nine of the indictment that, during June 2002, Stewart made or caused to be made a series of false and misleading public statements about her sale of ImClone stock "in an effort to stop or at least slow the steady erosion of [MSLO's] stock price caused by

investor concerns [about the government investigations]."³²

Stewart Moves to Dismiss Count Nine

In October 2003, Stewart moved to dismiss the securities fraud charges in Count Nine of the indictment on statutory and constitutional grounds.³³ First, relying on a more than 700-page appendix that included a large number of news reports, she argued that her alleged misstatements about her ImClone trades were immaterial as a matter of law, could not have misled MSLO investors, and could have had no material effect on MSLO's stock price. Second, she argued that her personal statements about the charges against her were not actionable securities fraud because they were not made "in connection with" the purchase or sale of MSLO securities. Third, Stewart argued that the application of Rule 10b-5 in the criminal context to her personal statements about her personal conduct was unconstitutionally vague and violative of due process. Finally, Stewart argued that the action against her violated the First Amendment by unconstitutionally criminalizing and limiting her free speech rights to respond to false and damaging media reports and congressional leaks about the investigation.

Materiality

In claiming that her June 2002 statements were immaterial as a matter of law, Stewart argued that her public claims of innocence did not inject any new information into the marketplace.

[T]he immateriality of her June 2002 statements is obvious considering the torrent of negative publicity about Ms. Stewart that flooded the market at the very time she made these statements. The market was saturated with devastatingly negative and unrelenting reports and commentary about the congressional, SEC and [U.S. Attorney's] investigations into Ms. Stewart's ImClone transaction. Congressmen appeared on national television and, not so subtly, called Ms. Stewart a liar. Analysts told investors not to buy her company's stock because of the uncertainty the investigations created. Columnists criticized her, lampooned her, and opined on her guilt.³⁴

Going far beyond the face of the indictment, Stewart's attorneys set out a compelling narrative about the massive publicity surrounding Stewart in June 2002, weaving together press accounts, pointing the finger at named and unnamed congressional sources, and making it hard to fathom how Stewart's statements could have had any material impact on MSLO stock, especially since the

stock price kept falling throughout June 2002. Given the "total mix of information" in the market about MSLO, Stewart argued that no reasonable investor would have found her explanations material.³⁵

Further, Stewart argued that the overwhelming coverage of the public controversy concerning the ongoing government investigations neutralized any impact of her denials.³⁶ Stewart pointed to analysts' negative evaluations of MSLO stock and to the steady decline in MSLO's stock price as additional evidence of immateriality.³⁷

"In Connection with . . ."

In contending that her June 2002 statements were not made "in connection with" the purchase or sale of MSLO securities, Stewart posited that her statements were personal statements about personal charges, "not statements made on behalf of" MSLO.³⁸ "This was not a comment by Ms. Stewart, in her role as CEO, that MSO's flagship magazine subscriptions were up, that sales of MSO's furniture line were booming, or that MSO had record cash reserves on hand and expected a banner earnings year."³⁹ Acknowledging that MSLO had stated in securities filings that Stewart's reputation was material to MSLO's success, Stewart argued nonetheless that the "'in connection with' requirement is not so elastic that it can be stretched to make every *non-corporate* misstatement concerning the personal reputation of corporate executives a federal crime."⁴⁰

Vagueness and Due Process

Stewart's "as applied" vagueness and due process challenge focused on whether the securities fraud laws provided both "notice" that Stewart's conduct was unlawful and "explicit standards" by which to judge whether Stewart broke the securities laws.⁴¹ Arguing that the void-for-vagueness rule applies with special force in criminal prosecutions involving speech, Stewart spun a number of hypotheticals about the possible peccadillos of key corporate executives in an attempt to show that the government's unprecedented interpretation of Rule 10b-5 is "boundless and standardless."⁴² Stewart argued that although MSLO depended heavily on her reputation, she was no different in this way from many, many other corporate executives, all of whom would be shocked, as she and

some noted securities law experts were, by a criminal prosecution based on personal statements not pertaining to her company's securities.⁴³

The First Amendment

The flow of Stewart's First Amendment defense was fascinating.⁴⁴ Stewart argued that Count Nine "violate[d] [her] First Amendment right to speak and to defend herself on a matter of public concern";⁴⁵ that strict scrutiny "applies to this attempted criminalization of speech";⁴⁶ and that, in effect, the government was punishing Stewart for exercising her right to reply to government leaks and adverse press reports.⁴⁷ In defending her reputation, Stewart claimed that her June 2002 statements about ongoing issues of public concern were especially protected because she was also entitled to the presumption of innocence.⁴⁸

Stewart posited that Count Nine flunked the strict scrutiny test because the government had no interest in criminalizing even false unsworn statements about personal conduct. Stewart stressed the prosecution's chilling effect on executives and on corporate lawyers:

What corporate officer will speak out now and risk the prosecutor adding charges with heavier

potential penalties? What lawyer for a corporate officer will speak out now? The Damoclean sword of a criminal securities fraud prosecution hangs over every word. Any statement of innocence, even about purely personal conduct, may now be viewed by an overzealous prosecutor as a false statement (false because the prosecution believes the defendant to be guilty) material to the stock price of the company.⁴⁹

Finally, Stewart claimed that the prosecution constituted unconstitutional viewpoint discrimination "favoring the *government's own* speech over speech of the defendant."⁵⁰

The Government Responds

Although Stewart's motion previewed impressive, fact-intensive themes from her counsel's jury argument, the government's response emphasized both the heavy burden a criminal defendant bears in seeking to dismiss an indictment and the sufficiency of this indictment's allegations.⁵¹ Laden with bright-line tests and tenets of strict construction, the government scolded Stewart for her voluminous supporting appendix and accused her of trying to transplant summary judgment practice into criminal cases. For the government, an indictment that tracks the statutory language of the elements of the crime is

more than sufficient to survive a motion to dismiss.

Materiality

The government argued powerfully that materiality cannot be determined on a motion to dismiss. Emphasizing that Judge Sprizzo of the Southern District of New York had denied Stewart's motion to dismiss in the class action securities fraud case based in part on Stewart's statements in June 2002,⁵² the government selected certain facts from Stewart's appendix that, in its view, made materiality at least a fact question for the jury.⁵³ The government also cited occasional upward movements in the MSLO stock price during June to demonstrate that Stewart's statements could have had some impact on a reasonable investor.⁵⁴

"In Connection with . . ."

The government further argued that whether Stewart made her June 2002 statements "in connection with" the purchase or sale of securities was another classic jury question because the indictment tracked the statutory language. Stewart was parsing the facts too finely, according to the government, by claiming

Why the Court Denied Stewart's Motion to Dismiss Count Nine

"Count 9 does not charge Ms. Stewart with lying by asserting her innocence. The indictment charges that she made materially false statements of fact regarding her sale of ImClone securities with the intention of defrauding and deceiving investors by showing [sic] or stopping the erosion of the value of the securities issued by her own company, Martha Stewart Living Omnimedia. This is unquestionably a novel application of the securities laws. However, that does not change the standard by which the sufficiency of the indictment must be judged.

"Ms. Stewart's arguments with respect to Count 9 are based, in large part, on predictions as to what the government will be able to prove at trial, not on defects on the face of the indictment.

"The indictment alleged that Ms. Stewart's statements in June 2002 were material and made in connection with securities transactions. The indictment

also provides facts to show the materiality of the statements and their relationship to securities transactions.

"With respect to the two statements that repeated allegedly false information that Ms. Stewart had previously released, the indictment alleges that the market price of the MSLO stock rose after each statement was made. Given the fact-intensive nature of the materiality determination and the broad scope of the in-connection-with requirement, it cannot be said that the indictment's allegations as to these matters fail as a matter of law to charge a crime. On the face of the indictment, before hearing the evidence, I cannot remove these factual issues from the jury.

"Ms. Stewart's argument that Count 9 violates her First Amendment rights is also not persuasive. . . . Count 9 does not charge that Ms. Stewart committed securities fraud by asserting her innocence, but that she made false

statements of fact that were material to investors' decisions to purchase or sell securities. Such false factual statements are not protected by the First Amendment. The Constitution does not prohibit the prosecution of lies that are part of a course of criminal conduct.

"Ms. Stewart also argues that the securities fraud statute, which Count 9 charges that she violated, is unconstitutionally vague as applied to the conduct charged. . . .

"Count 9 alleges that her statements were made with the intent to defraud purchasers and sellers of the stock of her company and to maintain the value of her own stock by preventing a further decline in the stock market's price, which had already declined because of publicity about the facts that her statements addressed. The securities statute gives adequate notice that such conduct is prohibited."

—Hearing Transcript at 6-9

that her statements were personal statements rather than corporate statements. Highlighting MSLO's prior statements about Martha Stewart's importance to MSLO's success, the government contended that the "in connection with" requirement was satisfied because the indictment sufficiently alleged "facts showing that . . . [her] statements were the type of statements upon which reasonable investors rely."⁵⁵

Vagueness and Due Process

The government responded to Stewart's "as applied" vagueness challenge by focusing on the requirement that it prove scienter beyond a reasonable doubt to convict. The scienter requirement removed any possibility of inadequate notice to Stewart of the illegality of her conduct and protected against "arbitrary or discriminatory enforcement."⁵⁶ The government again belittled Stewart's "personal statements" argument and tried to distinguish the prosecution of Stewart from the potential prosecution of real and imagined corporate executives for alleged lies about other types of personal matters. "It strains belief that Stewart was blissfully ignorant that affirmatively lying about her possible culpability for violating the federal securities laws, which could jeopardize her continued ability to run MSLO and which would obviously be material to MSLO investors, could not result in her criminal prosecution."⁵⁷ Stewart's contrary contentions were "absurd[]."⁵⁸

The First Amendment

Turning to Stewart's First Amendment arguments, the government emphatically argued that Stewart was not being charged with securities fraud because of her "assertions of innocence."⁵⁹ The government wrote thus:

Stewart did not merely claim that she was innocent. Stewart did not merely express a belief that she would be cleared of accusations of wrongdoing. Instead, Stewart gave a forceful, detailed and false explanation for her sale of ImClone. . . . To make sure that she was heard, Stewart repeated her false explanation four times. . . .⁶⁰

The government then cited *Gertz v. Robert Welch, Inc.*, for the proposition that "there is no constitutional value in false statements of fact"⁶¹ and argued that where, as here, "proof of scienter is required, false statements of fact are removed from the ambit of First Amendment protection."⁶² The government went further, relying on *Rice v.*

Paladin Enterprises,⁶³ among other cases, and contended that "the First Amendment does not apply to speech that is itself part of the commission of a crime."⁶⁴ Dismissing Stewart's claim of viewpoint or content discrimination as "nonsensical," the government concluded that Stewart's deliberately false speech was exactly the type of speech that should be chilled by criminal prosecution.⁶⁵

Stewart's Motion Denied

The court set Stewart's Motion to Dismiss Count Nine for hearing on November 18, 2003. Without hearing argument, the court made short shrift of the motion. The court initially noted that a defendant seeking to dismiss an indictment faces "a high threshold. She must show that Count[] . . . 9 on [its] face fails [] to charge a crime."⁶⁶ The court's explanation for its action appears in the sidebar on page 6.

Conclusion

On the eve of opening statements on January 26, 2004, Judge Cedarbaum cosseted the prosecution in granting several government motions *in limine*, ruling that Stewart's lawyers cannot argue to the jury that Stewart is being prosecuted for asserting her innocence or for exercising her First Amendment rights or that Count Nine is a "novel use of the securities laws."⁶⁷ The clash of securities fraud charges and First Amendment rights in the government's prosecution of Stewart has created new corporate anxieties and uncertainties.

Slate's Henry Blodget aptly summed up the problems arising from this conflict:

[T]his precedent hurts not only falsely accused executives, but also investors—the people who the securities laws are supposed to protect.

- If the accused executive is guilty and admits guilt, this is fair. The stock will justifiably get hammered.
- If the accused executive is guilty, denies guilt, but doesn't explain for fear of getting charged with securities fraud, this is also fair. With no explanation, investors will be skeptical of the denial, and the stock will justifiably get hammered (although, if one is going to consider false explanations a crime, it seems logically inconsistent that false denials are not considered a crime).
- If the accused executive is innocent, denies guilt, and doesn't explain for fear of getting charged with securities fraud, this is unfair. The lack of an explanation will be construed as guilt, and the stock will get hammered unjustifiably.

- If the accused executive is innocent, denies guilt, explains, and then gets charged with securities fraud, this is awful, for both the executive and investors—the stock will get hammered even though no one committed a crime.⁶⁸

Corporate executives, their lawyers, spokespeople, and public relations firms have awaited the court's further rulings to see whether this unprecedented criminalization of public protestations of innocence is "unconstitutional and unwise," as Stewart contends,⁶⁹ or entirely appropriate because false public statements have no constitutional value and are the crime itself, as the government argues so strenuously.

Epilogue

After several weeks of testimony and at the close of the government's case, Martha Stewart moved for a judgment of acquittal on all counts against her. Judge Cedarbaum refused to dismiss the conspiracy, obstruction of justice, and false statement counts, but granted Stewart's motion to dismiss the securities fraud claim in Count Nine.

Judge Cedarbaum's twenty-three-page opinion does not rely on immateriality, unconstitutional vagueness, freedom of speech, or any of the other grounds raised by Stewart in her pre-trial motions to dismiss the securities fraud count. The sole basis for the court's opinion is the insufficiency of the evidence presented by the government and the court's conclusion that "no reasonable juror can find beyond a reasonable doubt that the defendant lied for the purpose of influencing the market for the securities of her company."⁷⁰

Judge Cedarbaum first noted that the higher standard of proof applicable to criminal cases – "beyond a reasonable doubt" – made a difference in the court's assessment of the sufficiency of the evidence. The court then explained that the evidence presented at trial, when viewed in the light most favorable to the government, allowed the jury to find the following facts:

- Stewart had a significant financial stake in MSLO;
- Stewart was aware of the market price of her company's stock and of matters that could affect the price of that stock;
- Stewart was aware of the importance of her reputation to the continued health of MSLO; and
- Stewart believed that the price of MSLO was falling in response to the

negative publicity about the investigations of her ImClone trading.⁷²

However, Judge Cedarbaum noted that the government had presented no evidence that Stewart expressed concerns to anyone about the response of MSLO stock to the negative publicity. Thus, the Court held that “a reasonable juror could not, without resorting to speculation and surmise, find beyond a reasonable doubt that Stewart’s purpose was to influence the market in MSLO securities.”⁷³

Judge Cedarbaum’s decision to dismiss the securities fraud count in the indictment is “a good thing” for Martha Stewart, but the basis for the decision – insufficiency of the evidence – does not eliminate the concerns about such claims in future cases. While some prosecutors may be dissuaded from bringing securities fraud claims based on protestations of innocence, it is no longer a novel theory and Judge Cedarbaum’s earlier ruling gives some credence to the viability of such a claim.

The jury is beginning its deliberations as this goes to press.

Endnotes

1. *In re* Application of ABC, Inc., 2004 WL 299175 (2d Cir. Feb. 18., 2004); *see Polling Jury Pool*, at www.newsday.com/news/printedition/longisland/ny-nymart233638973jan23,0,788913.story (describing closure of voir dire and release of voir dire transcripts). Judge Cedarbaum, of course, has presided over at least one criminal trial where an anonymous jury was used. *See* www.ganglandnews.com/Cedarbaum.htm (describing anonymous jury selection in *United States v. Massaro* in 1993).

2. At least some of the civil actions alleging securities fraud are pending before Judge Sprizzo in the Southern District of New York; however, a shareholder derivative action filed in Delaware against directors of MLSC was dismissed.

3. Unless otherwise noted, all factual allegations are taken from the Superseding Indictment, *United States v. Stewart*, No. 03 Cr. 717 (MGC) (S.D.N.Y. 2003) [hereinafter Indictment] or from the civil complaint filed by the Securities and Exchange Commission (SEC). For sustained commentary on these criminal proceedings, *see generally* Henry Blodget’s occasional series, *Dispatches from the Martha Stewart Trial*, at www.slate.msn.com. For Stewart’s side of the story, *see generally* www.marthatalks.com.

4. Indictment at 5–6.

5. Memorandum of Law in Support of Martha Stewart’s Omnibus Pre-Trial Motions at 4 (Oct. 6, 2003) [hereinafter Memorandum]. On February 12, 2004, the FDA reversed itself and approved Erbitux.

6. *See* Indictment at 6–7.

7. *Id.* at 3–5.

8. *Id.* at 7.

9. *Id.* at 7–8.

10. *Id.*

11. *Id.* at 8–9.

12. *Id.* at 9–11, 17–19. The government also interviewed Faneuil several times, beginning on January 3, 2002. Misdemeanor Information at 5–6, *United States v. Faneuil*, No. 02-CR-1287 (KNF) (S.D.N.Y. 2002) [hereinafter Information].

13. Indictment at 12–15, 19–20. Stewart was not placed under oath for either interview, and neither interview was recorded or transcribed. Memorandum at 5.

14. *See* Indictment at 17.

15. A stop-loss order is a written instruction from a client to her stockbroker to sell shares when they reach or drop below a certain price.

16. Indictment at 10–15, 17–20.

17. *Id.* at 12–15, 19–20.

18. *Id.* at 11–12.

19. *Id.* at 13.

20. *Id.* at 15–17.

21. Memorandum at 6, 8–22.

22. Indictment at 36–37.

23. *Id.* at 37–38.

24. *Id.* at 38; *see* Memorandum at 14–16; *see also* *United States v. Waksal*, No. 02 Mag. 1186 (S.D.N.Y. 2002). The SEC also sued Waksal civilly for insider trading. Sec. & Exch. Comm’n v. Waksal, No. 02 CV 4407 (S.D.N.Y. 2002).

25. Memorandum at 17; Indictment at 38–39.

26. Indictment at 40–41; Memorandum at 25–26.

27. Indictment at 41.

28. *Id.* at 36.

29. Information at 6.

30. *See* Information. Faneuil has not yet been sentenced.

31. Conversely, the SEC has sued Stewart civilly for insider trading in ImClone stock, but has not sued Stewart civilly for securities in connection with her June 2002 statements. Memorandum at 6.

32. Indictment at 37; *see id.* at 35–41.

33. *See* Memorandum. Around the same time, Dr. Sam Waksal pleaded guilty to six counts, including securities fraud, bank fraud, conspiracy to obstruct justice, and perjury in connection with his ImClone trading activities. Waksal did not reach any plea agreement with the government and, in January 2004, was sentenced to seven years in prison and ordered to pay a \$3.5 million fine.

34. *Id.* at 7.

35. *See, e.g., Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000); *see* Memorandum at 51–57. On February 13, Judge Cedarbaum ruled that the government cannot introduce expert testimony about the alleged materiality of Stewart’s statements.

36. Memorandum at 33–36.

37. *Id.* at 43, 48–51.

38. *Id.* at 58.

39. *Id.* at 61.

40. *Id.* (original emphasis).

41. *Id.* at 62 (citing, e.g., *United States v. Handakas*, 286 F.3d 92, 111 (2d Cir. 2002)).

42. *Id.* at 64–65.

43. *Id.* at 66–71. In a related argument, Stewart complained that the Rule of Leniency required dismissal because reasonable doubt lingered about whether the securities fraud laws were intended to reach Stewart’s conduct. *Id.* at 73–74.

44. *Id.* at 74–86.

45. *Id.* at 74.

46. *Id.*

47. *Id.* at 74–76.

48. *Id.* at 76–77.

49. *Id.* at 84.

50. *Id.* at 86.

51. *See* Government’s Memorandum of Law in Opposition to Defendant Stewart’s Motion to Dismiss Counts Eight, Nine, and Three Specifications of Counts Four and Five (Nov. 5, 2003) [hereinafter Opposition].

52. *Id.* at 23–24. According to the government, Judge Sprizzo said he found Stewart’s argument that the statements were immaterial as a matter of law “hard to swallow.” *Id.* at 23.

53. *Id.* at 24–29.

54. *Id.* at 25–28.

55. *Id.* at 47; *see id.* at 44–49.

56. *Id.* at 54; *see id.* at 49–63.

57. *Id.* at 57–58.

58. *Id.* at 59.

59. *Id.* at 64.

60. *Id.*

61. 418 U.S. 323, 339 (1974); *see* Opposition at 65.

62. Opposition at 66.

63. 128 F.3d 233, 242 (4th Cir. 1997).

64. Opposition at 67; *see id.* at 67–68.

65. *Id.* at 69; *see id.* at 69–70.

66. Hearing Transcript at 4.

67. Henry Blodget, *Back-Room Deals and Heads on Platters*, at www.slate.msn.com (visited Jan. 26, 2004).

68. *Some Preliminary Conclusions*, at www.slate.msn.com (visited Dec. 23, 2003).

69. Memorandum at 1.

70. Opinion, at 3–4 (Feb. 27, 2004) [hereinafter Opinion].

71. This statement arguably suggests that the decision to dismiss Count Nine might have come out differently in a civil context. However, the Court later states that the government action against Martha Stewart is one of those rare cases where “the evidence of an essential element of a charged crime is ‘nonexistent or so meager that no reasonable jury could find guilt beyond a reasonable doubt.’” *Id.* at 3 (quoting *United States v. Gradagna*, 183 F.3d 122, 130 (2d Cir. 1990) (quoting *United States v. White*, 673 F.2d 299, 301 (10th Cir. 1982))(internal quotation marks omitted)).

72. Opinion at 7, 9–10.

73. *Id.* at 16.