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The Trial of Martha Stewart

From indictment to sentencing, the case of Martha Stewart was a matter of intense public interest. Some thought that her misdeeds, if any, were slight. Cynics believed the government was prosecuting a celebrity for a minor infraction to show it was tough on business crime. An indignant *Wall Street Journal* complained that innocent employees and shareholders of Martha Stewart Living Omnimedia were paying the price for the government's zeal.¹ Feminists argued that she was picked on for being a successful woman. "It's hard to imagine a male in precisely this spot," said Mary Becker, a DePaul University law professor. "Targeting a successful woman is very consistent with dominant cultural values."²

Others believed that her prosecution was justified. "I don't buy any of it," wrote Scott Turow, a criminal defense lawyer and the author of best-selling legal fiction. "What the jury felt Martha Stewart did—lying about having received inside information before she traded—is wrong, really wrong."³

This is the story.

DECEMBER 27

On the morning of Thursday, December 27, 2001, Douglas Faneuil was on duty at the mid-Manhattan office of Merrill Lynch. Faneuil, 24, who had been in his job only six months, assisted a stockbroker named Peter Bacanovic. It was two days after Christmas and Bacanovic was on vacation. Staffing was thin and Faneuil expected a slow day with light trading.

Soon Faneuil took a call from Aliza Waksal. Aliza was the daughter of Samuel Waksal, co-founder of ImClone Systems, a biopharmaceutical company. She wanted to sell her ImClone shares. Faneuil executed the order and by 9:48 a.m. her 39,472 shares had been sold for \$2,472,837. Then Faneuil had a call from Samuel Waksal's accountant requesting that another 79,797 shares held in his Merrill Lynch account be transferred to Aliza's account and then

¹ "The Trials of Martha," *The Wall Street Journal*, February 13, 2004, p. A12.

² Quoted in Jonathan D. Glater, "Stewart's Celebrity Created Magnet for Scrutiny," *The New York Times*, sec. 1, p. 1.

³ Scott Turow, "Cry No Tears for Martha Stewart," *The New York Times*, May 27, 2004, p. 29.

sold. The call was followed by a written direction saying that making the transfer and sale that morning was imperative.

Faneuil sought help on the transfer and called Peter Bacanovic in Florida. Bacanovic, 39, was an old friend of Waksal's. He had worked at ImClone for two years before coming to Merrill Lynch, and he handled the personal accounts of Waksal and his daughter. When Bacanovic learned that the Waksals were selling, he instructed Faneuil immediately to call another of his clients, Martha Stewart, while he remained on the line.

Bacanovic, who was active in New York social life, first met Martha Stewart in the mid-1980s when they were introduced by her daughter Alexis. Stewart was one of his most important clients. He handled her pension and personal accounts. He also handled accounts for her company, Martha Stewart Living Omnimedia, Inc.

At 10:04 a.m. Faneuil dialed Stewart, but reached her administrative assistant Ann Armstrong, who said Stewart was on an airplane. Bacanovic left a brief message, asking Stewart to call back when she became available. In her phone log, Armstrong wrote, "Peter Bacanovic thinks ImClone is going to start trading downward." Bacanovic instructed Faneuil that when Stewart called back he should tell her that the Waksals were selling all their shares. At this time ImClone was priced at \$61.53 a share.

This instruction from Bacanovic bothered Faneuil. Merrill Lynch had a written policy (see Exhibit 1) that required its employees to hold client information in strict confidence. But he was very busy and working under a sense of urgency, handling calls from the Waksals, and making calls to Merrill Lynch staff in several offices arranging the transfer of Sam Waksal's shares to his daughter.

Several hours later, Stewart's plane landed in San Antonio to refuel. She went into the airport and on her cell phone called Ann Armstrong to check for messages. At 1:39 p.m. she phoned Merrill Lynch, reaching Faneuil, who told her that Sam Waksal and his daughter had sold all of their shares. She asked for the current price of ImClone. Faneuil quoted approximately \$58 a share. Stewart told him to sell all 3,928 shares she owned.

EXHIBIT 1**Client
Information
Privacy Policy**

Merrill Lynch protects the confidentiality and security of client information. Employees must understand the need for careful handling of this information. Merrill Lynch's client information privacy policy provides that—

- Employees may not discuss the business affairs of any client with any other employee, except on a strict need-to-know basis.
- We do not release client information, except upon a client's authorization or when permitted or required by law.

She hung up and immediately put in a call to Sam Waksal. The two were close friends who had been introduced by Stewart's daughter Alexis in the early 1990s. Unable to reach him, she left a message that his assistant took down as "Martha Stewart something is going on with ImClone and she wants to know what."⁴ By 1:52 p.m. Stewart's ImClone shares had been sold at an average price of \$58.43, for a total of approximately \$228,000.

THE PUZZLE OF THE WAKSAL TRADES

What was going on with ImClone? For almost 10 years Waksal had put ImClone's resources into the development of a promising new colon cancer drug named Erbitux. Two months earlier, ImClone had submitted a licensing application for approval of Erbitux to the Food and Drug Administration (FDA). On December 26, Waksal learned from an ImClone executive that, according to a source within the FDA, on December 28 ImClone would receive a letter rejecting the Erbitux application. When the FDA's action was publicly announced ImClone's share price was sure to plummet.

Waksal was in possession of material insider information. It was material because any reasonable investor would find it important in deciding to buy or sell ImClone stock. It was insider information because it was not yet known to the public. Since the FDA application was so critical, ImClone's general counsel had declared a "blackout period" after December 21 when employees should not trade ImClone shares. The purpose of the blackout was to guard against illegal insider trading.

Despite being informed of the blackout and despite possessing knowledge of the law with respect to insider trading, Waksal elected to sell. This was exceptionally foolish. His motive was to escape the unpleasant consequences of debt. He had obligations of \$75 million, most of which was margin debt secured by shares he owned in ImClone. Servicing this debt was costing him \$800,000 a month. He knew that if ImClone's share price slipped very far, many of his shares would be sold, dramatically lowering his net worth. He also tipped family and friends to sell on December 27. Besides his daughter Aliza, his father sold 135,000 shares, his sister Patti sold 1,336 shares, and another daughter, Elana, sold 4,000 shares. Waksal also tipped an investment adviser who sold all of her 1,178 shares on December 27 and passed the tip to a physician on one of ImClone's advisory boards, who sold more than \$5 million in shares—all he owned—on the same day.

On Friday, December 28, the FDA faxed ImClone a "refusal to file" letter at 2:55 p.m. Later in the afternoon, after the market closed with ImClone trading at \$55.25 a share, the company issued a press release disclosing the FDA's action. On December 31, the next trading day, ImClone opened at \$45.39 a share. If Martha Stewart had waited until then to sell her shares, she would have gotten about \$178,292 or \$49,708 less than she received by selling on the afternoon of December 27. ImClone closed on December 31 at \$46.46. It had dropped about 16 percent on the news of the FDA's action.

AN UNSETTLED AFTERMATH

Four days later a supervisor at Merrill Lynch questioned Faneuil about the ImClone trades. Afterward, Faneuil called Bacanovic, who was still vacationing in Florida. Bacanovic told him that Martha Stewart sold her shares because of a prearranged plan to

⁴ Complaint, *Securities and Exchange Commission v. Martha Stewart and Peter Bacanovic*, 03CV 4070 (NRB)(S.D.N.Y.), June 4, 2003, p. 7.

reduce her taxes. He told Faneuil about a December 20 telephone call in which he and Stewart had gone down a list of the stock holdings in her account deciding which ones to sell at a loss to balance out capital gains from other sales during 2001.

Soon, however, Faneuil had a call from Eileen DeLuca, Martha Stewart's business manager, who demanded to know why the ImClone shares had been sold, since the sale had resulted in a profit that disrupted her tax-loss selling plan. Again he called Bacanovic. This time, Bacanovic told him that Stewart had sold because they had a preexisting agreement to sell ImClone if the price fell below \$60 a share.

Merrill Lynch contacted the Securities and Exchange Commission (SEC) to report suspicions of insider trading in ImClone. On January 3, 2002, SEC attorneys called Faneuil to interview him. Faneuil told them Stewart had sold because the price of ImClone fell below \$60 a share. He did not tell them that he had conveyed news about the Waksals' sales to her. On January 7, SEC attorneys interviewed Bacanovic on the telephone. He told them he had spoken to Martha Stewart on the day she traded and recommended that she sell based on their preexisting \$60 sell agreement.

On January 16, Martha Stewart and Peter Bacanovic had a breakfast meeting. Their conversation is unrecorded. According to Faneuil, after the meeting Bacanovic told him, "I've spoken to Martha. I've met with her. And everyone's telling the same story . . . This was a \$60 stop-loss order. That was the reason for her sale. We're all on the same page, and it's the truth."⁵ In at least five subsequent conversations, Bacanovic reassured Faneuil of the need to stick to this story. If he did, Bacanovic promised to give him extra compensation.

On January 30, in response to a request for documents by the SEC, Bacanovic turned over the worksheet that he said was used in his December 20 tax sale conversation with Martha Stewart. It was a single-page printout listing approximately 40 securities in her account and noting the number of shares and the purchase price. The notation "@60" appeared near the entry for ImClone.

On January 31, Martha Stewart had a lengthy conversation with a criminal attorney. Following the conversation she went to her assistant Ann Armstrong

⁵ Brooke A. Masters, "Stewart Ordered Sale, Says Witness," *The Washington Post*, February 5, 2004, p. E1.

asking to see the telephone log. Sitting at Armstrong's computer, she changed Bacanovic's December 27 phone message from "Peter Bacanovic thinks ImClone is going to start trading downward," to "Peter Bacanovic re imclone."⁶ Then, thinking better of it, she told Armstrong to restore the original wording and left.

INTERVIEWS

On February 2, Martha Stewart was interviewed in New York by attorneys from the SEC, the Federal Bureau of Investigation (FBI), and the U.S. Attorney's Office. Asked to explain her ImClone transaction, she said she and Bacanovic had decided to sell if ImClone fell below \$60 a share. On December 27 she had spoken to Bacanovic, who told her it had fallen below \$60 and inquired if she wished to sell. She had assented, in part, because she was on vacation and did not want to worry about the stock market. She did not recall speaking to Faneuil on that day. She denied knowledge of the December 27 phone message from Bacanovic, even though only two days before she had gone to her assistant's computer to alter its wording. According to one attorney present, at the end of the interview Stewart asked in a "curt, annoyed" tone, "Can I go now? I have a business to run."⁷

On February 13, Bacanovic was subpoenaed by the SEC to testify under oath in New York. He reported a December 20 phone call with Stewart in which he recommended the sale of ImClone if it fell below \$60. The worksheet he turned over to the agency had notes of this conversation. He also stated that he had not discussed the ImClone stock sale with Stewart since December 27. Yet records of calls between Bacanovic's and Stewart's cell phones show that by this time they had spoken often, including once on the day of Stewart's interview in New York. The content of their conversations is unrecorded.

On March 7, Douglas Faneuil was interviewed by SEC attorneys. Details of this session have not been made public, but his subsequent indictment alleges that he failed to fully and truthfully disclose all he

⁶ Matthew Rose and Kara Scannell, "Dramatic Flourishes at Stewart, Tyco Trials," *The Wall Street Journal*, February 11, 2004, p. C1.

⁷ Thomas S. Mulligan, "Jurors Hear of Attempt by Stewart to Alter Phone Log," *Los Angeles Times*, February 11, 2004, p. C7.

knew about the events of December 27.⁸ Following the interview, Bacanovic offered Faneuil an extra week of vacation and airfare for a trip as a reward for sticking to Bacanovic's script.⁹

On April 10, Stewart was interviewed again on the telephone by investigators. She told them she had spoken with Bacanovic on December 27, but she could not remember if Bacanovic had mentioned the Waksals. She said again that the two had set up a \$60 sell order on ImClone.

TURMOIL

After these interviews, government investigators continued the painstaking work of gathering, verifying, and interpreting details. Meanwhile, the main actors in the ImClone trades struggled in the backwash of their actions. In late May, Samuel Waksal resigned as the CEO of ImClone. In early June, the Associated Press broke the story that Martha Stewart was being investigated, setting off a three-week decline in the share price of Martha Stewart Living Omnimedia. Merrill Lynch suspended Peter Bacanovic without pay.

When Waksal was arrested and charged with criminal insider trading on June 12, shares in Stewart's company fell 5.6 percent. Waksal would eventually plead guilty to insider trading charges, receive a prison sentence of 87 months, and pay a fine of \$4 million. The family members were forced to disgorge the profits from their trades, with interest, and the two other tippees—the investment adviser and the physician—paid disgorgement of profits, interest, and civil fines totaling \$112,000 and \$2.7 million, respectively.

Stewart issued a statement saying she and her broker had agreed on a \$60 sell order in October 2001, that he had called her on December 27 and told her ImClone was trading under \$60, and that she had told him to sell in line with their prior understanding. She denied having nonpublic information at the time. Later in the month she repeated this story at a conference for securities analysts and investors. Her intent was to halt the decline in her company's shares. At this time she held 61,323,850 shares and had suffered paper losses of more than \$462 million over three weeks.

⁸ Misdemeanor Information, *United States v. Faneuil*, 02 Cr. 1287, S.D.N.Y. (2002), pp. 7–8.

⁹ *Ibid.*, p. 8.

Douglas Faneuil's conscience bothered him. In late June he went to a manager at Merrill Lynch and volunteered what he believed was the complete and accurate story of December 27 and its aftermath. Subsequently, he spoke again to government investigators, who then subpoenaed both Stewart and Bacanovic to testify at an investigative hearing. This time, both declined, invoking their Fifth Amendment privilege against self-incrimination. Faneuil pled guilty to a misdemeanor charge of accepting money from Bacanovic in return for not informing federal investigators of illegal conduct. Merrill Lynch fired Bacanovic.

INDICTMENTS

It took the government a year and a half, but on June 4, 2003, in a "coordinated action," both the U.S. Attorney's Office and the SEC filed indictments against Martha Stewart and Peter Bacanovic.

The U.S. Attorney's Office filed a criminal complaint with multiple counts under the basic charges of, first, conspiracy, and second, obstruction of justice and making false statements.¹⁰ The two were charged with conspiring to conceal evidence that Bacanovic had given nonpublic information about ImClone to Stewart. And they were accused of lying to government attorneys to hamper the investigation. In addition, only Martha Stewart was charged with securities fraud. The charge was that she had made a series of false statements about her innocence to mislead investors and prop up her company's share price. Conviction on all counts could bring a maximum of 30 years in prison and a fine of \$2 million. Bacanovic alone was additionally charged with perjury for altering the worksheet that listed Stewart's stocks by adding "@60" near ImClone to fool investigators. He faced a maximum of 25 years in prison and a \$1.25 million fine.

In its separate civil action, the SEC charged Stewart and Bacanovic with insider trading.¹¹ It sought disgorgement of illegal gains and the imposition of a fine. In addition, it sought to bar Stewart from acting as a director or officer of a public company.

¹⁰ *United States v. Martha Stewart and Peter Bacanovic*, 03 Cr. 717 (MGC)(S.D.N.Y.), 2003.

¹¹ *Securities and Exchange Commission v. Martha Stewart and Peter Bacanovic*, 03 CV 4070 (NRB)(S.D.N.Y.), 2003.

Martha Stewart's lawyers immediately issued a statement challenging the government's case. "Martha Stewart has done nothing wrong," they said. They accused the government of making an "unprecedented" interpretation of the securities laws when it charged her with fraudulent manipulation simply because she spoke out publicly to maintain her innocence. And they questioned the government's motive for the other charges, raising themes that would course through the media during the subsequent trial.

Is it for publicity purposes because Martha Stewart is a celebrity? Is it because she is a woman who has successfully competed in a man's business world by virtue of her talent, hard work and demanding standards? Is it because the government would like to be able to define securities fraud as whatever it wants it to be?¹²

A week later, Martha Stewart went to the FBI's Manhattan office for processing. She was given a mug shot, fingerprinted, and released without bail. She also resigned her positions as director and chief creative officer of Martha Stewart Living Omnimedia, taking on the nonofficer position of founding editorial director. She continued to receive her annual salary of \$900,000 and in 2003 she was awarded a \$500,000 bonus.

THE TRIAL OPENS

On January 20, 2004, Martha Stewart and Peter Bacanovic appeared in the Manhattan courtroom of the Hon. Miriam Goldman Cedarbaum, a federal district court judge with 18 years' bench experience. They entered pleas of not guilty and jury selection began. Potential jurors were given 35 pages of questions designed to detect biases. One question was, "Have you ever made a project or cooked a recipe from Martha Stewart?"¹³ Eight women and four men were picked.

The trial began January 27. The lead prosecutor was Assistant U.S. Attorney Karen Patton Seymour. In her opening argument she told the jury that Martha

Stewart sold ImClone after a "secret tip" from Bacanovic that the Waksals were selling. Then, she and Bacanovic tried to cover it up. Stewart's motive, she argued, was a desire to protect her multimillion-dollar business empire. Seymour pointed out that every \$1 decline in the stock price of Martha Stewart's company decreased her net worth by \$30 million. "Ladies and gentlemen," she said, "lying to federal agents, obstructing justice, committing perjury, fabricating evidence and cheating investors in the stock market—these are serious federal crimes."¹⁴

In his opening argument Stewart's attorney, Robert G. Morville, pronounced her "innocent of all charges" and tried to offer reasonable explanations for her actions. He pointed out that the ImClone shares she sold were less than 1 percent of her net worth. He told the jury that December was a busy month for her and she gets worn out. When she called Faneuil about the trade she was in a noisy airport on her cell phone and thought she was talking to Bacanovic. She had no way of knowing that insider trading was taking place. "How," he asked, "was she supposed to figure out the broker, who has always been honorable, was asking her to commit a crime?" If, indeed, she had been told that Waksal and his daughter were selling, it meant that Merrill Lynch was making the sales, which it would not do if it believed them to be illegal.

Morville explained that Stewart and Bacanovic had established a \$60 sell agreement the week before her trades. And he called Stewart's alteration of her assistant's entry in the phone log "much ado about nothing." He said that she was changing it "to be consistent with what she recalled," but then quickly realized that her change "might be misconstrued." He concluded his opening statement by asking the jury to "decide the case based upon what is correct and just."¹⁵

TESTIMONY

Key witnesses for the government were Helen Glotzer, an SEC attorney, and Catherine Farmer, an FBI agent. Both had been present at interviews of Stewart and

¹² Robert G. Morville and John J. Tigue, "Press Statement," June 4, 2003, at www.marthatacks.com/trial.

¹³ Thomas S. Mulligan, "Stewart Case Poses Challenges for All Parties as Trial Begins Today," *Los Angeles Times*, January 20, 2004, p. C1.

¹⁴ Kara Scannel and Matthew Rose, "Early Sparks at the Stewart Trial," *The Wall Street Journal*, January 28, 2004, p. C1.

¹⁵ Quotations of Morville are from "Opening Argument on Behalf of Martha Stewart," January 27, 2004, at www.marthatacks.com/trial.

Bacanovic and both testified about apparent false statements, including Stewart's denial that she spoke with Faneuil on December 27 and her denial that she knew that the Waksals were selling.

The government's star witness, however, was Douglas Faneuil. Under questioning by Seymour, Faneuil described his morning phone call to Bacanovic on December 27. On learning that the Waksals were selling Bacanovic said: "Oh my God, you've got to get Martha on the phone!" Faneuil said that he then asked Bacanovic, "Can I tell her about Sam? Am I allowed to?" "Of course," replied Bacanovic, "That's the whole point."¹⁶ When Martha Stewart called in that afternoon, she asked, "What's going on with Sam?" Faneuil said that he told her, "We have no news about the company, but we thought you might like to act on the information that Sam is selling all his shares." He described her end of the conversation as a series of "clipped demands."

Faneuil also recounted how Bacanovic had tried to pull him into a cover-up. He described a scene at a coffee shop near their office in which he told Bacanovic, "I was on the phone. I know what happened." In response Bacanovic put an arm around him and said, "With all due respect, no, you don't."¹⁷

During cross-examination Bacanovic's attorney, David Apfel, tried to tarnish Faneuil as an unreliable witness. He called Faneuil an admitted liar who had changed his story seeking leniency from prosecutors. He brought out Faneuil's use of recreational drugs. And he introduced e-mail messages by Faneuil to show that he disliked Martha Stewart and might have held a grudge against her. One read: "I just spoke to MARTHA! I have never, ever been treated more rudely by a stranger on the telephone." Another was: "Martha yelled at me again today, but I snapped in her face and she actually backed down! Baby put Ms. Martha in her place!!!"¹⁸ Faneuil also testified about a time when he put Martha Stewart on hold. When he came back on the line she threatened to pull her account from Merrill Lynch unless the hold music was changed. Jurors laughed.

¹⁶ Brooke A. Masters, "Broker's Aide Says He Was Told to Tip Off Stewart," *The Washington Post*, February 3, 2004, p. E1.

¹⁷ Testimony quoted in Constance L. Hays, "Witness Describes Stewart Cover-Up," *The New York Times*, February 5, 2004, p. C4.

¹⁸ Brooke A. Masters, "Broker's Assistant, Stewart Clash," *The Washington Post*, February 5, 2004, p. E1.

Faneuil's testimony took 13 hours over six days. On his last day he was cross-examined by Stewart's attorney Morvillo, who tried to depict him as overwhelmed by the rush of events on December 27. He pointed out that Faneuil had taken 75 phone calls that day and some e-mails. He questioned why his memory of Stewart's call was sharp, in contrast to some other calls about which he was less clear. He got Faneuil to admit that he suspected the Waksals of insider trading, but said nothing to Bacanovic.

Following Faneuil, Stewart's administrative assistant Ann Armstrong was called to testify about how Stewart altered the message of Bacanovic's call. Taking the stand, she began to sob. After getting a glass of water from the defense table she tried to resume, but could not. Judge Cedarbaum recessed the trial to the next day, when Armstrong recounted how Stewart first altered, then instructed her to restore, the wording of the phone message.

Maria Pasternak was a friend who had been traveling with Martha Stewart on December 27. Pasternak related conversations with Stewart at a resort in Los Cabos over the following days. She said Stewart told her that the Waksals were trying to sell all their shares in ImClone and that she had sold all her shares. She testified that Stewart remarked, "Isn't it nice to have brokers who tell you those things?" But under cross-examination she vacillated about the clarity of her recall. The judge instructed jurors to disregard the remark.

An expert ink analyst with the U.S. Secret Service was called for his analysis of Bacanovic's tax sale worksheet. Larry Stewart, who is not related to Martha Stewart, testified that tests he conducted showed two pens had been used on the worksheet. All the notations on it, except "@60," were made by a "cheap" Paper Mate pen. The "@60" was written with a second, unidentified pen. The second pen did not match any of 8,500 ink samples on record, so he concluded it was either foreign or very rare.¹⁹ This was important evidence for the prosecution, which argued that the "@60" had been added only after December 27, when the defendants constructed a cover-up.

After the prosecution finished its case, Martha Stewart's lawyers elected to use a minimal defense. They called only one witness, a former Stewart lawyer

¹⁹ Matthew Rose and Kara Scannell, "Stewart Trial Gets Testimony of a Broker's Tip," *The Wall Street Journal*, February 20, 2004, p. C3.

and note-taker at the February 4 meeting with investigators, who testified for only 15 minutes. There was much speculation about whether Martha Stewart would take the stand in her own defense. If she did, prosecutors would push her, try to trap her in inconsistencies and provoke her temper. If she did not, the intense curiosity of the jurors to learn what she could say to them would be unfulfilled. In the end, she did not take the stand.

Late in the trial Judge Cedarbaum dismissed the government's allegations of securities fraud. This charge had met with wide skepticism from the beginning. How could a defendant exercise her right to speak out in self-defense if doing so could be construed as criminal manipulation of share prices? Cedarbaum held that, given the evidence, no reasonable juror could find her guilty beyond a reasonable doubt.²⁰

After the defense called its single witness, there had been 27 witnesses during 19 days of testimony. Closing arguments came on March 2. Prosecutor Michael Schachter told jurors that Stewart and Bacanovic believed they would never be caught. But mistakes they made trying to deceive left a trail of damning inconsistencies. He carefully listed contradictions in their stories. Bacanovic's lawyer gave a closing argument trying once again to undermine the credibility of Douglas Faneuil's testimony.

In his closing argument for Martha Stewart, Morvillo ridiculed the conspiracy charge, saying the events alleged by the government amounted to "a confederation of dunces."²¹ Nobody, he argued, "could have done what Peter Bacanovic and Martha Stewart are alleged to have done and done it in a dumber fashion." He asked the jurors to consider that if the two had really conspired they would have been much more consistent in their stories. Their inconsistencies were a sign of innocence. This was a dangerous argument, because it conceded some contradictions in testimony.

Morvillo then made the case for Stewart's innocence. She had no evidence that anything was wrong with the trade. She had no reason to suspect that Waksal would behave so foolishly as to trade during a blackout period. She had a preexisting agreement

with her broker to trade ImClone if it fell below \$60. She could not hear well enough on the phone to know she was talking to Faneuil, not Bacanovic. The amount of the trade was too small to tempt jeopardizing her future. Her change in Ann Armstrong's telephone log was insignificant. Faneuil was an untrustworthy witness. Finally, he explained that she did not take the stand because she twice testified on the record at investigative hearings two years before and "her recollection [of the events] hasn't gotten any better." He concluded with this.

This has been a two-year ordeal for this good woman. It's an ordeal based on the fact that she trusted her financial adviser not to put her in a compromising position. It's an ordeal based on the fact that she voluntarily submitted to a government interview. And it's an ordeal that is in the process of wiping out all the good that she has done, all her contributions, all her accomplishments . . . Martha Stewart's life is in your hands . . . I ask you to acquit Martha Stewart. I ask you to let her return to her life of improving the quality of life for all of us. If you do that, it's a good thing.²²

THE VERDICT

The jury deliberated for 14 hours over three days. On March 5 one female juror wept as the verdicts were announced. Stewart and Bacanovic were each found guilty on four counts of lying and conspiring to lie to conceal the fact that she had been tipped with insider information. However, the jury could not agree that the government had proved beyond a reasonable doubt its allegation that Stewart and Bacanovic fabricated the \$60 sale agreement and it acquitted them on those counts.

Jurors described their deliberations as calm. They found Faneuil credible and gave much weight to his testimony. Ann Armstrong was also an important witness because she cried. "We feel that she knew that something was wrong," said the forewoman. Jurors were also suspicious of the January 16 breakfast meeting between Stewart and Bacanovic and they felt cynical about Stewart hiring a criminal defense lawyer even before she was contacted by government investigators. They put little stock in the

²⁰ *United States v. Martha Stewart and Peter Bacanovic*, 305 F. Supp. 2d 368, February 27, 2004.

²¹ "Closing Argument on Behalf of Martha Stewart," March 2, 2004, at www.marthatacks.com/trial, p. 1.

²² *ibid.*, p. 10.



Martha Stewart outside the Manhattan courthouse after hearing the verdict. Source: © AP Photo/Julie Jacobson.

"conspiracy of dunces" argument. "We felt that she was a smart lady who made a dumb mistake," said the forewoman.²³

A juror named Chappell Hartridge characterized the verdict as "a victory for the little guys who lose money in the market because of these kinds of transactions."²⁴ After looking into Hartridge's background, Stewart's legal team believed he had not been completely honest on his jurors' questionnaire. When asked about contacts with law enforcement, he did not disclose an arrest for assaulting a former girlfriend, and several other problems. Arguing that they would have exercised a challenge to keep Chappell off the jury had they known, her lawyers moved for a new trial. Judge Cedarbaum ruled that the allegations were little more than hearsay and there was no evidence that bias in Chappell affected the verdict.²⁵

Meanwhile, prosecutors had filed a criminal complaint against Larry Stewart, the ink expert who testified at the trial. Stewart was accused of perjury for

saying that he had conducted the ink tests after a co-worker came forward saying that, in fact, she had done them. Again Stewart's attorneys filed a motion for retrial. Again Cedarbaum denied the motion, because "there was no reasonable likelihood that this perjury could have affected the jury's verdict, and because overwhelming independent evidence supports the verdict . . ."²⁶ Subsequently, Larry Stewart was tried and, based on evidence that his co-worker had a history of harassment, acquitted of perjury.²⁷

SENTENCING

On July 16, 2004, Martha Stewart appeared before Judge Cedarbaum. Addressing the judge, she appealed for leniency, saying, "Today is a shameful day. I ask that in judging me, you remember all the good I've done and the contributions I've made." Prosecutor Seymour countered, arguing that Stewart was "asking for leniency far beyond" that justified for "a serious offense with broad implications" for the justice system. Judge Cedarbaum responded, "I believe that you have suffered, and will continue to suffer, enough."²⁸ Her sentence was five months' imprisonment followed by five months' of home confinement. She was fined \$30,000. This set of penalties was at the light end of what could have been imposed under federal sentencing guidelines and showed that Judge Cedarbaum was using what discretion she had to avoid a harsh sentence.

After the sentencing, Martha Stewart emerged from the courthouse to read a less contrite statement. "I'm just very, very sorry that it's come to this, that a small personal matter has been able to be blown out of all proportion, and with such venom and such gore—I mean, it's terrible."²⁹

At a separate hearing that day, Peter Bacanovic received a nearly identical sentence of five months in prison, five months of home confinement, and a \$4,000 fine. A week later Daniel Faneuil appeared before Judge Cedarbaum. Tearfully, he apologized for

²³ Kara Scannell, Matthew Rose, and Laurie P. Cohen, "In Stewart Case, Reluctant Jurors Found Guilt after Skimp Defense," *The Wall Street Journal*, March 8, 2004, p. A1.

²⁴ Constance L. Hays, "Martha Stewart Seeks New Trial, Saying a Juror Lied," *The New York Times*, April 1, 2004, p. C3.

²⁵ *United States v. Martha Stewart and Peter Bacanovic*, 317 F. Supp. 2d 426, May 5, 2004.

²⁶ *United States v. Martha Stewart and Peter Bacanovic*, 323 F. Supp. 2d 606, July 8, 2004.

²⁷ "Jurors Acquit Stewart Witness," *Los Angeles Times*, October 6, 2004, p. C3.

²⁸ Thomas S. Mulligan, "Stewart Gets 5 Months in Prison, Then Delivers a Plug for Her Firm," *Los Angeles Times*, July 17, 2004, p. A4.

²⁹ *Ibid.*, p. A1.

his actions. His cooperation with federal prosecutors saved him from going to prison. His sentence was a \$2,000 fine.

On October 8, Martha Stewart reported to a minimum-security prison camp in West Virginia to begin her incarceration. She had appealed her case, but the appeal was expected to take two years. Therefore, she elected to serve her sentence. Doing so would end much of the speculation and tumult affecting both her and her company.

She served her time. In prison she worked in the garden and cleaned the warden's office for 12 cents an hour. She disliked the food but made some friends among the other women. She gave them yoga lessons and a seminar on entrepreneurship. Her last day of home confinement (extended three weeks due to a violation that was not publicly explained) ended on September 1, 2005. In 2006 a federal appeals court turned down her request to overturn her conviction.³⁰ Then she settled with the SEC, which had brought a civil case of insider trading against her in 2003. In the settlement, she neither admitted nor denied guilt. She agreed to a five-year ban on serving as an officer or director of her company and a \$195,081 fine. In the same settlement,

Bacanovic agreed to a fine of \$75,645.³¹ Stewart's legal troubles were finally over with the end of court-ordered probation in March 2007.

Questions

1. Did Martha Stewart commit the crime of insider trading when she sold her ImClone shares on December 27, 2001?
2. Did the U.S. attorneys and the Securities and Exchange Commission use good judgment in indicting Martha Stewart? Do you believe that her indictment was based on evidence of a serious crime, or do you believe that prosecutors consciously or unconsciously had additional motives for pursuing the case?
3. Do you agree with the jury that she was guilty beyond a reasonable doubt of the conspiracy and obstruction of justice charges?
4. Was her punishment, including both imprisonment and fines, appropriate? Were the punishments of Peter Bacanovic and Douglas Faneuil appropriate?

³⁰ *U.S. v. Martha Stewart and Peter Bacanovic*, 433F. 3d 273 (2006).

³¹ See Securities and Exchange Commission, Litigation Release No. 19794, *SEC v. Martha Stewart and Peter Bacanovic*, 03 Civ. 4070 (RJH) (S.D.N.Y.), August 7, 2006.



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