

**MARTHA STEWART'S  
LEGAL TROUBLES**



# MARTHA STEWART'S LEGAL TROUBLES

EDITED BY

**Joan MacLeod Heminway**

THE UNIVERSITY OF TENNESSEE  
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## ACKNOWLEDGMENTS

It has been my privilege to work with an outstanding group of legal scholars in composing this volume. I read their related work before asking them to participate, and I read and edited their completed chapter manuscripts—and I still respect and like them after all that! If that doesn't say something about the quality of these authors, I don't know what does....

Of course, behind each of us is a cast of characters serving in various supporting roles. Many of us worked with research assistants to assist us in completing original works that appear in edited form in this book or to compose our chapters for inclusion in this book. Special thanks go to Miranda Christy, Mara Davis, Kimberly Ford, Tamara Lindsay, and David Patterson in that regard. All, or nearly all, of the authors would acknowledge that errors in reprinted works were caught by the editors and staff of the various law reviews and journals in which we originally published those works. Accordingly, we should acknowledge the editors and staff of the *American Criminal Law Review*, *Buffalo Criminal Law Review*, *Cardozo Law Review*, *Lewis & Clark Law Review*, *Maryland Law Review*, *Ohio Northern University Law Review*, *Penn State Law Review*, *Texas Journal of Women and the Law*, and *Washburn Law Journal*. Reprint permissions, where required, were granted by these law reviews and journals, for which we also thank the editors.

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JMH  
October 2006



# INTRODUCTION

Martha Stewart is a modern media icon. She has sought out and achieved public notoriety in her life and work. As such, she requires no personal or professional introduction in these pages.

Yet, Stewart's legal troubles have put her in a new kind of limelight. Since 2002, lawyers and legal scholars—some of whom knew next-to-nothing about Stewart at the turn of the century—have become interested in Stewart's sale of 3,928 shares of common stock in a company called ImClone Systems Incorporated and its legal aftermath. A veritable academic "cottage industry" has grown up around Stewart's related interactions with law and the legal system. Stewart's investigation, prosecution, and criminal trial have become case studies for those interested in identifying and exploring the strengths and weaknesses of federal criminal law and procedure in the white collar crime context. Moreover, securities law experts have fixated not only on the U.S. Securities and Exchange Commission's cutting-edge application of federal insider trading regulation under Rule 10b-5 to the Stewart stock trade, but also on the unusual criminal charge brought against Stewart for securities fraud under that same federal securities regulation, Rule 10b-5. And corporate law folks have become interested in legal issues emanating from related stockholder derivative litigation brought in Delaware for asserted breaches of fiduciary duty.

It is this growing body of work that compelled the creation of this volume. The contributing authors are law professors and legal scholars specializing in criminal, corporate, or securities law. Although the book is intended principally as a supplemental resource for academic courses involving white collar crime and business law both in and outside the law school context, its contents also are likely to be of interest to practicing lawyers in these fields and to heartier (!) elements of the general public who desire to understand more about Stewart's interactions with law and the legal system than the public news media typically can convey. It is for all of these audiences that we write this book.

## The Basic Format of this Volume

The chapters in this volume are organized into three main parts. Each chapter tells a discrete legal story and can be read either on its own or together with other chapters of the volume. All of the chapters, however, are united in their use of Martha Stewart's legal troubles as a jumping-off point or case study. The text of each chapter is followed by several questions relating to the chapter that can be used by students and other readers as a means of confirming and extending their understanding of the text. Each chapter then concludes with full legal scholarship endnotes.

### *Part I*

Part I includes Chapters 1 through 5. This part addresses pretrial enforcement issues (principally— although not exclusively— questions relating to prosecutorial discretion, including the discretion to charge criminal conduct).

Along those lines, Chapter 1 focuses on the legal claim for which Stewart originally was investigated—a possible insider trading violation in connection with Stewart's December 2001 sale of ImClone Systems Incorporated common stock. In this chapter, Professor Joan MacLeod Heminway identifies various ways in which Rule 10b-5, the U.S. Securities and Exchange Commission's key rule governing insider trading, can be selectively enforced in insider trading cases. Building on these ideas, Professor Heminway suggests ways in which the investigation of Martha Stewart may have been biased.

In Chapter 2, Professor Ellen S. Podgor asserts that, for various reasons, increasing types of objectionable conduct are being criminalized. The chapter describes various aspects of this "overcriminalization," which Professor Podgor ultimately contends is responsible for the criminal prosecution of Stewart.

The remainder of Part I is devoted to various perspectives on the prosecutorial discretion to charge criminal conduct and the relationship of those perspectives to the criminal charges for which Stewart was indicted. In Chapter 3, Professors Michael L. Seigel and Christopher Slobogin identify the Stewart prosecution as an example of "redundant charging"—the pursuit of a criminal defendant on multiple related charges for the same conduct. Professors Seigel and Slobogin critique this practice and suggest that courts adopt a "law of counts" to better manage the prosecutorial process.

Chapter 4 explains how the breadth and depth of U.S. federal criminal law impacted Stewart's indictment and contemporaneous criminal actions involving Arthur Andersen and Enron. In this chapter, Professor Geraldine Szott Moohr expresses concern about the power vested in federal prosecutors in this

broad, deep, legal construct (an adversarial system in name only), which she contrasts with the European inquisitorial system. Ultimately, she concludes that a “[c]lose examination of inquisitorial processes is likely to provide insights for dealing with the imbalance between prosecutor and defendant that now characterizes the federal system.”

Finally, Chapter 5 hones in on the Rule 10b-5 securities fraud charge brought against Stewart in her criminal indictment. Here, Professor Heminway assesses the validity of that unusual charge in light of both the elements of a Rule 10b-5 claim and the elements of prosecutorial discretion. Although she finds a basis for the Rule 10b-5 action against Stewart in both sets of elements, her analysis raises questions as to whether Rule 10b-5 should be used by prosecutors in this manner.

## *Part II*

Part II consists of Chapters 6 through 10. This part of the book directly addresses the substance of the criminal charges brought against Stewart in June 2003. In Chapter 6, provocatively entitled “Martha, Scooter, and Slick Willy: Uncovering the Cover-up Crimes,” Professor Stuart P. Green looks at the types of criminal prosecutions brought against Stewart, I. Lewis (“Scooter”) Libby, and former President Bill (“Slick Willy”) Clinton, among others—prosecutions for crimes committed in covering up other possible wrongful conduct. Noting that public reactions to these types of charges vary, Professor Green constructs an analytical framework for use in determining when cover-ups are blameworthy and applies that framework in analyzing the cover-up charges brought against Stewart.

Chapter 7 focuses specifically on the obstruction of justice charge leveled against Stewart. In that chapter, Professor Podgor uses the *Stewart* case as a catalyst for suggesting that obstructive conduct should not be criminally actionable unless it is material. Among other things, Professor Podgor argues that materiality should be a required element of proof for obstruction of justice because of the inclusion of materiality in other, similar criminal statutes.

The last three chapters of Part II of this volume concentrate on the securities fraud charge brought against Stewart in Count Nine of her criminal indictment. In Chapter 8, Professor Heminway critiques the judicial decision to acquit Stewart of that charge. Her reflections relate to matters of criminal procedure, substantive law, and legal reasoning. Ultimately, Professor Heminway concludes that the evidence of scienter in the *Stewart* case was sufficient to present to the jury for decision. However, she also notes that an opinion grant-

ing a judgment of acquittal could have been constructed on alternative grounds that were left undecided by the *Stewart* court.

Professor Donald C. Langevoort also is critical of the court's determination to grant a judgment of acquittal to Stewart on the securities fraud charge. To that end, Chapter 9 represents Professor Langevoort's analysis of the state of mind—or "scien ter"—element of the Rule 10b-5 charge against Stewart. In this chapter, Professor Langevoort outlines the somewhat amorphous (and often misunderstood) nature of the scien ter component of a Rule 10b-5 action and uses research in behavioral law and economics to clarify these murky scien ter waters. He then applies his analysis to the Stewart judgment of acquittal on the securities fraud charge. He concludes both that the court misconstrued the scien ter requirement in rendering its decision and that Stewart seemingly had the required state of mind based on a behavioral science analysis. He then reflects on the scien ter component of the SEC's settled civil insider trading claim against Stewart, concluding that scien ter may have provided viable bases for a defense in that civil action.

Focusing on another element of the securities fraud charge against Stewart, Chapter 10 examines whether Stewart's alleged misstatements are "material" under prevailing Rule 10b-5 standards and case law. In this chapter, Professor Heminway outlines the Supreme Court's key pronouncements on materiality and applies them to the facts of the *Stewart* case, concluding that Stewart's public statements are not apparently material.

### *Part III*

Part III of this volume turns to legal issues external to the Stewart criminal trial. Each of the three chapters in this part of the book covers a distinct topic. In Chapter 11, Professor Kathleen F. Brickey describes and considers three post-trial matters emanating from the *Stewart* case. Specifically, the chapter focuses on questions relating jury selection and misconduct, the alleged perjured testimony of a government expert witness, and federal sentencing parameters and discretion. Each of these issues is important in its own right as a miniature case study of the penumbra of a large-scale criminal trial. These trials seem to be surrounded by spin-off legal issues that prolong their existence and continue to impact the lives of those involved. Interestingly (at least for Stewart followers), Professor Brickey concludes that these post-trial matters and the continued legal issues involving and invoking Stewart's trading in ImClone's securities may inure to Stewart's long-term benefit.

Chapter 12 turns directly to the insider trading claims brought against Stewart by the U.S. Securities and Exchange Commission in June 2003. These are

claims that never were tried. (The Commission and Stewart settled these charges in the summer of 2006.) In this chapter, Professor Jeanne L. Schroeder explains the principal insider trading theories—classic insider trading and misappropriation—in terms of the passions of envy and jealousy as they apply to property. Using literature in theology, psychology, and philosophy, Professor Schroeder defines the concepts of envy and jealousy and their relationship to property rights and relates this construct to the two dominant theories of insider trading. Professor Schroeder ultimately determines that the misappropriation theory, the theory under which Stewart was pursued for insider trading liability, is confused and contradictory because it (unlike classic insider trading) is rooted in trade secret principles and manifests as envy. In the process, Professor Schroeder rationalizes the classic theory of insider trading regulation as a fitting response to jealousy—an appropriate protection of public company property rights conferred upon investors under the federal securities laws. Moreover, she uses her analysis to question the validity of the U.S. Securities and Exchange Commission’s insider trading charges against Stewart.

Finally, Chapter 13 concludes the volume with a reflection on the Delaware stockholder derivative suit against Stewart, yet a third cause of action arising out of the same single sale of ImClone common stock that led to the criminal action and civil insider trading proceeding addressed in the preceding 12 chapters. In this chapter, Professor Lisa M. Fairfax describes both the ways in which director independence comes into play in Delaware shareholder derivative litigation and the historic role that social ties have played in the judicial assessment of director independence. She then identifies both the promise and challenges associated with the consideration of social ties in making independence assessments and suggests a way in which courts can resolve the resulting conflict.

## Editorial Notes

There are many ways that this book can be read other than “cover to cover.” I offer here a few suggestions based on my perspectives on the text and my experience as a law professor. These ideas are in no way intended to be limiting; rather, they are intended to stimulate further thought about how to creatively use the included material in classroom teaching and book discussion groups.

### *Prosecutorial Process*

For those interested in the benefits and detriments of our current federal system of criminal prosecution, I recommend the whole of Part I of the book, Chapters 1-5. Each chapter provides a different view of the decision to pros-

ecute Stewart. Was she targeted because of who she was, in addition to or in lieu of what she did? Was her conduct really the “stuff” of federal criminal law? Was she charged for too many crimes based on the same alleged wrongful conduct? Does our federal system of prosecution afford too much power to prosecutors in a case like Stewart’s? Did prosecutors in the *Stewart* case have sufficient discretion and substantive grounds to charge Stewart with each of the crimes of which she was accused? The chapters in Part I address these and other related issues.

### *White Collar Crime*

Stewart’s 2004 criminal action raised a number of interesting federal criminal law and procedure issues that are addressed most directly in Chapters 6, 7, and 11. The different, yet overlapping, elements of crimes involving false statements and obstruction of justice are at issue in Chapters 6 and 7, while Chapter 11 focuses on the application of the laws and processes governing jury selection and conduct, perjury, and sentencing to specific circumstances involving the *Stewart* case.

### *Securities Fraud and Insider Trading*

The elements of federal securities fraud under Rule 10b-5 are covered in varying ways in Chapters 5, 8, 9, and 10, with Chapters 5 and 8 offering a general treatment based on the Stewart criminal indictment and acquittal and Chapters 9 and 10 presenting in-depth analyses of scienter and materiality respectively, as distinct elements of the federal criminal securities law charge against Stewart.

Those interested in Stewart’s possible insider trading violations under Rule 10b-5 (the matter for which she originally was pursued by the U.S. government) should find Chapters 1, 9, and 12 most helpful in advancing their understanding. The substantive law of insider trading is summarized in both Chapters 1 and 12, and the scienter element of the insider trading case brought against Stewart is analyzed in Chapter 9. These chapters underscore the complexity of federal insider trading regulation.

### *Delaware Corporate Law*

Chapter 13 explores a single Delaware corporate law issue raised by a stockholder derivative suit brought against Stewart and her fellow directors of Martha Stewart Living Omnimedia, Inc.—whether director social ties may be taken into account in determining director independence and, if so, how those ties should be assessed. This is an important issue under Delaware law on

which the courts have not been entirely clear or consistent over time. At the risk of reopening a corporate law Pandora’s Box, this chapter tackles both the issue and a solution—and in the process, effectively forces the reader to question the specialized civil procedure rules applicable to stockholder derivative actions under Delaware law.

### *Comparative Legal Systems*

Although American legal scholars often are ethnocentric in their reflections on law and legal policy, theory, and systems, Chapter 4 provides some comparative context on prosecutorial power and discretion in its discussion of differences in the U.S. federal model for criminal prosecutions and the European inquisitorial prosecutorial system. This chapter indicates that we may have something to learn about criminal procedure from our brothers and sisters in France....

### *Law and Behavioral Finance*

Chapter 9 provides insights on the application of cognition research to the important “state of mind” element of a federal securities fraud violation under Rule 10b-5. By describing and applying this research and existing behavioral finance scholarship to the scienter requirement, this chapter contributes to a burgeoning corporate finance literature that has become important to our understanding of the way in which our securities markets operate—and should operate.

### *Law and Literature*

Students (literal or figurative) of literature and others desiring to further their cultural literacy are likely to find Chapter 12 an interesting read. This chapter uses well-known and lesser-known literature in philosophy, psychology, and religion to illuminate and inform the murky law of insider trading.

## **Sources and Citations**

Legal scholarship is, by tradition, heavily footnoted and multi-sourced. In an effort to make the text of this volume more readable, we have used chapter endnotes, rather than footnotes. Citations are presented in *Bluebook* form (conforming as nearly as possible to the Eighteenth Edition of *The Bluebook, A Uniform System of Citation*, published in 2005 and distributed by The Harvard Law Review Association).

