MARTHA STEWART SAVED! INSIDER VIOLATIONS OF RULE 10B-5 FOR MISREPRESENTED OR UNDISCLOSED PERSONAL FACTS

JOAN MACLEOD HEMINWAY*

On February 27, 2004, a federal district court judge sitting in New York acquitted Martha Stewart of securities fraud.[1] The charge on which the court acquitted Stewart was based on the claim that Stewart had willfully misrepresented a material fact in connection with the purchase or sale of a security.[2] The material fact allegedly misrepresented was Stewart's publicly articulated reason for the sale of 3,928 shares of common stock of ImClone Systems Inc. (ImClone) on December 27, 2001.[3] According to the government's case, this alleged misstatement regarding Stewart's sale of ImClone's stock—a personal

---

* Visiting Professor, Boston College Law School (Fall 2005); Associate Professor, The University of Tennessee College of Law. A.B., Brown University; J.D., New York University School of Law. Professor Heminway is a subscriber to *Martha Stewart Living* magazine and the owner of books published and merchandise sold by Martha Stewart Living Omnimedia, Inc. The idea and background research for this Article were presented at the University of Maryland School of Law Symposium on *Women and the "New" Corporate Governance*, at a research forum sponsored by The University of Tennessee Corporate Governance Center, and at the 2005 Law and Society Association annual conference. The author gratefully acknowledges the comments received from attendees of those presentations and the counsel and research assistance of Tamara Lindsay, a member of The University of Tennessee College of Law Class of 2007. Special thanks are due to Dwight Aarons, Gerry Moohr, and Ellen Podgor, each of whom read and commented on this Article in draft form. Finally, this Article would not have been written without the encouragement and support of Lisa M. Fairfax and generous research funding from The University of Tennessee College of Law.

1. *See* United States v. Stewart, 305 F. Supp. 2d 368, 370 (S.D.N.Y. 2004) (granting Martha Stewart's motion for a judgment of acquittal on the securities fraud charge).

2. Superseding Indictment ¶¶ 56-66, United States v. Stewart, S1 03 Cr. 717 (MGC) (S.D.N.Y. Jan. 7, 2004), *available at* http://news.findlaw.com/hdocs/docs/mstewart/usmspb10504sind.html [hereinafter Indictment]; *Stewart*, 305 F. Supp. 2d at 370 ("Count Nine of the Indictment charges that defendant Stewart made materially false statements of fact regarding her sale of ImClone securities with the intention of defrauding and deceiving investors by slowing or stopping the erosion of the value of the securities issued by her own company, Martha Stewart Living Omnimedia . . . ."). The Indictment also suggests that the statements made by Stewart were misleading in that they omitted certain material facts. Indictment, *supra*, ¶¶ 60-61, 63-64. For ease of reference and because the essence of the claim against Stewart lies in alleged misrepresentations, this Article will merely reference the basis of the claims as "misrepresentations" or "misstatements."

3. Specifically, the Indictment alleges that "STEWART made or caused to be made a series of false and misleading public statements during June 2002 regarding her sale of ImClone stock on December 27, 2001 that concealed and omitted that STEWART had been provided information regarding the sale and attempted sale of the Waksal Shares and

transaction—was made by her in an effort to maintain an artificially high market price for the publicly traded common stock of Martha Stewart Living Omnimedia, Inc. (MSLO), the corporation founded by Stewart and built around her domestic and marketing talents.[4]

Commentators, including legal scholars, have asked a number of questions about the securities fraud charges in the *Stewart* case. Among these questions: whether bringing the securities fraud charge was an appropriate use of prosecutorial discretion and whether the judge's acquittal of Stewart was correct as a matter of law.[5] This Article further explores both of these questions in light of applicable legal standards and the elements of a criminal action for securities fraud and then uses the knowledge gained from these explorations to analyze the circumstances under which a corporate insider like Stewart is likely to be found guilty in a criminal action or liable in a civil action for securities fraud for a misstatement or omission of information relating to a personal fact or transaction—information of a personal na-

---

that STEWART had sold her ImClone stock while in possession of that information." Indictment, *supra* note 2, ¶ 60.

4. *Id.* ("STEWART made these false and misleading statements with the intent to defraud and deceive purchasers and sellers of MSLO common stock and to maintain the value of her own MSLO stock by preventing a decline in the market price of MSLO's stock."); Geraldine Szott Moohr, *Prosecutorial Power in an Adversarial System: Lessons from Current White Collar Cases and the Inquisitorial Model*, 8 BUFF. CRIM. L. REV. 165, 179 (2004) ("The government's theory was that Stewart committed securities fraud when she publicly asserted her innocence. According to the prosecution, her denials of wrongdoing were materially false statements, made with the intent to defraud investors by slowing or stopping the erosion of the company's share value.").

5. *See, e.g.*, Lawrence S. Goldman, *Martha and Lynne: The Stewart Sisters and the Expansion of White Collar Criminal Prosecution*, 27 CHAMPION 8, 8 (2003) (criticizing the use of criminal prosecution for fraud in the *Stewart* case); Stuart P. Green, *Uncovering the Cover-Up Crimes*, 42 AM. CRIM. L. REV. 9, 13 (2005) (critiquing the lack of a rigorous method for prosecutors and others to analyze charges for so-called cover-up crimes); Moohr, *supra* note 4, at 177-82 (critiquing the prosecution's power to decide what to charge, using the *Stewart* case as an example); Dale A. Oesterle, *Early Observations on the Prosecutions of the Business Scandals of 2002-03: On Sideshow Prosecutions, Spitzer's Clash with Donaldson over Turf, the Choice of Civil or Criminal Actions, and the Tough Tactic of Coerced Cooperation*, 1 OHIO ST. J. CRIM. L. 443, 452-53 (2004) (characterizing the Stewart prosecution as an example of a prosecutor "piling-on"); Ellen S. Podgor, *Jose Padilla and Martha Stewart: Who Should Be Charged with Criminal Conduct?*, 109 PENN ST. L. REV. 1059, 1068-70 (2005) (criticizing the prosecution for bringing "extraneous" charges against Stewart); Michael L. Seigel & Christopher Slobogin, *Prosecuting Martha: Federal Prosecutorial Power and the Need for a Law of Counts*, 109 PENN ST. L. REV. 1107, 1117-30 (2005) (questioning "redundant charging" in the *Stewart* case); Harvey A. Silverglate & Andrew Good, *Stop Creative Prosecutions*, NAT. L.J., Aug. 30, 2004, at 26, 26 (asserting that the Stewart securities fraud charge is an example of the use of a "creative prosecution" theory); Hans van der Touw et al., Opinion, *Martha Stewart Is No Ken Lay*, L.A. TIMES, June 8, 2003, at M4 (providing readers' comments criticizing the Indictment); Stephen Bainbridge, I Was Right: Count 9 Dismissed (Feb. 27, 2004), http://www.professorbainbridge.com/2004/02/i_was_right_cou.html (endorsing in a weblog post the judge's opinion acquitting Martha Stewart of securities fraud).

ture that does not involve the issuer of the securities as to which the fraud is alleged.[6]

Specifically, Part I of the Article presents a general overview of the elements of and burdens of proof for securities fraud actions like the one brought against Stewart. Part II briefly recounts the facts relevant to Stewart's securities fraud charge and the motion for acquittal resolved in favor of Stewart. Part III considers whether the prosecution's securities fraud charge against Stewart comports with law, reflecting on both prosecutorial standards relevant to charging decisions and the application of the elements of securities fraud to the facts of Stewart's case, as those facts were known at the time the final, Superseding Indictment was filed in January 2004 (Indictment). Similarly, Part IV examines the legal basis for the court's opinion acquitting Stewart of the criminal securities fraud charge before handing the remainder of the case to the jury. This examination requires a specific application of the elements of securities fraud to the facts of the *Stewart* case in the context of the judicial review standards for granting a motion to acquit. Part V summarizes and reflects on the analyses conducted in Parts III and IV, and Part VI offers a brief conclusion.

I. ALLEGATIONS AND PROOF: SECURITIES FRAUD UNDER RULE 10B-5

Martha Stewart was prosecuted by the U.S. government under section 10(b) of the Securities Exchange Act of 1934, as amended (1934 Act),[7] and Rule 10b-5 adopted by the Securities and Exchange Commission (SEC) under section 10(b) of the 1934 Act (Rule 10-b5).[8] Although actions brought under Rule 10b-5 have roots in common law actions for misrepresentation and deceit, the Supreme Court has long been clear that actions under Rule 10b-5 have their own ele-

---

6. In this Article, the author references "personal" and "private" facts, transactions, and information and uses these adjectives to distinguish the type of disclosures at issue in the *Stewart* case from public statements made by a corporate insider in her capacity as a corporate insider (which typically, although not always, would concern corporate—rather than personal—facts, transactions, or information).

7. 15 U.S.C. § 78j(b) (2000). Section 10(b) of the 1934 Act broadly prohibits manipulation and deception in connection with the purchase or sale of securities and authorizes the SEC to adopt rules and regulations "necessary or appropriate in the public interest or for the protection of investors." *Id.*

8. 17 C.F.R. § 240.10b-5 (2005). Rule 10b-5 proscribes the following in connection with the purchase or sale of a security: fraudulent devices, schemes, and artifices; certain misleading representations or omissions to state material fact; and acts, practices, and courses of business that "operate or would operate as a fraud or deceit." *Id.*

ments.[9] The elements of a securities fraud charge or claim under Rule 10b-5 differ depending on whether public (criminal or civil) or private enforcement is sought, but three principal elements are at the core of all Rule 10b-5 actions:

- manipulation or deception (including by the misrepresentation of, or omission to state, a material fact);[10]
- in connection with the purchase or sale of a security;[11]
- with scienter.[12]

Successful private actions under Rule 10b-5 also require pleading and proof of: standing (based on an actual purchase or sale of securities),[13] reliance by the plaintiff purchaser or seller on the defendant's conduct,[14] causation of the plaintiff's loss,[15] and damages.[16] Private actions are subject to a specific statute of limitations,[17] and class ac-

---

9. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 744-45 (1975) ("[T]he typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable.").

10. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 463 (1977) ("Only conduct involving manipulation or deception is reached by § 10(b) or Rule 10b-5."); *see also* THOMAS LEE HAZEN, 3 THE LAW OF SECURITIES REGULATION 570 (5th ed. 2005) (discussing the deception requirement of Rule 10b-5); MARC I. STEINBERG, SECURITIES REGULATION 523-24 (4th ed. 2004) (describing key elements of a section 10(b) claim).

11. *E.g.*, SEC v. Zandford, 535 U.S. 813, 819 (2002); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10 (1971); ALAN R. PALMITER, SECURITIES REGULATION 276-77 (2d ed. 2002); STEINBERG, *supra* note 10, at 524.

12. *E.g.*, Aaron v. SEC, 446 U.S. 680, 701-02 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976); HAZEN, *supra* note 10, at 203-04; STEINBERG, *supra* note 10, at 524.

13. *E.g.*, *Blue Chip Stamps*, 421 U.S. at 749; Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952); STEINBERG, *supra* note 10, at 523.

14. *E.g.*, Cent. Bank of Denver, N.A. v. First Interstate Bank, 511 U.S. 164, 180 (1994); Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988); STEINBERG, *supra* note 10, at 524.

15. *E.g.*, Huddleston v. Herman & MacLean, 640 F.2d 534, 549 n.24 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983); STEINBERG, *supra* note 10, at 524.

16. *E.g.*, Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627, 1629 (2005); STEINBERG, *supra* note 10, at 524.

17. *See* 28 U.S.C. § 1658(b) (Supp. 2004) (providing that a private right of action for, among other things, manipulation or deceit "may be brought not later than the earlier of—(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."); STEINBERG, *supra* note 10, at 524. There is no specific statute of limitations for criminal prosecutions under the 1934 Act. Decisional law therefore assumes that the general five-year period for federal crimes applies to criminal actions under Rule 10b-5. DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT 845 (2003). Although one federal circuit court has found that no statute of limitations applies to SEC enforcement actions, *SEC v. Rind*, 991 F.2d 1486, 1492 (9th Cir. 1993), it is possible that the general five-year statute of limitations provided in 28 U.S.C. § 2462 applies to enforcement actions under Rule 10b-5 (to the extent they do not seek equitable relief). *See, e.g.*, Catherine E. Maxson, Note, *The Applicability of Section 2462's Statute of Limitations to SEC Enforcement Suits in Light of the Remedies Act of 1990*, 94 MICH. L. REV. 512 (1995).

tions have certain specialized procedural and substantive requirements.[18] Criminal prosecutions under Rule 10b-5 are subject to constraints not applicable to civil claims, including requirements imposed by the 1934 Act and federal criminal procedure.[19]

A. Core Elements

1. Manipulation or Deception.—The requirement that a Rule 10b-5 claim involve manipulation or deception raises a question as to exactly what constitutes manipulation or deception. There is no definition of either term in the 1934 Act or in any rule or regulation promulgated by the SEC under section 10(b) of the 1934 Act. Rule 10b-5 itself (the SEC rule under the 1934 Act under which Stewart was prosecuted) does not adequately serve this definitional purpose.[20]

> Rule 10b-5 did not describe any particular practice that it deemed manipulative or deceptive, as the statutory scheme had anticipated. Instead, the SEC promulgated a regulation that spoke with the same generality as the statute, making it unlawful "[t]o employ any device, scheme, or artifice to defraud, [t]o make any untrue statement of material fact or . . . [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit.". . . The rule as promulgated drew upon no specific expertise of the SEC. Its generality meant, moreover, that either the Commission or the courts would have to give it substance through case-by-case adjudication.[21]

To a significant degree, the federal courts have determined the meaning of the relevant language in section 10(b) of the 1934 Act and Rule

---

18. *See* 15 U.S.C. § 78u-4 (2000) (providing specialized pleading requirements for private securities actions).

19. *See infra* notes 51-54, 76-78 and accompanying text (discussing additional requirements and the different standard of proof for criminal prosecution under Rule 10b-5). However, the same core elements applicable to public enforcement by the SEC are applicable in the criminal enforcement context, even if they may be interpreted somewhat differently. *See generally* Margaret V. Sachs, *Harmonizing Civil and Criminal Enforcement of Federal Regulatory Statutes: The Case of the Securities Exchange Act of 1934*, 2001 U. ILL. L. REV. 1025, 1054 (urging a single construction of prohibitions in "hybrid" statutes).

20. *See supra* note 8.

21. Edmund W. Kitch, *A Federal Vision of the Securities Laws*, 70 VA. L. REV. 857, 860-61 (1984) (footnote omitted); *see also* Norman S. Poser, Commentary, *Misuse of Confidential Information Concerning a Tender Offer as a Securities Fraud*, 49 BROOK. L. REV. 1265, 1278 (1983) ("Rule 10b-5—the only rule under section 10(b) that is used to prohibit misuse of non-public information—does not, however, define any specific practices."); Charles M. Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J. 54, 73 n.67 ("Rule 10b-5's prohibition of all 'fraudulent and deceptive' practices may not very clearly define the conduct being prohibited . . . .").

10b-5. The manipulation or deception element has been the subject of numerous decisions over the years since Rule 10b-5 was adopted.[22] As a general matter, the Supreme Court has stated that it views "manipulation" as more of a "term of art" relating to market transactions in securities.[23] Deception, on the other hand, involves dishonest conduct that has meaning in a broader context.[24] Legal scholars have contributed to the debate over the meaning of these terms.[25] Yet, clarity has not been achieved.

Moreover, Rule 10b-5 (read, as it must be, in light of section 10(b) of the 1934 Act), has three separate component parts, each of which addresses a different type of manipulative or deceptive conduct. "Significantly, this rule covers not only misrepresentations, but devices, schemes, or artifices to defraud; and acts, practices, and courses of business which could operate as a fraud."[26] Said another way, "market manipulation carries with it liability under Rule 10b-5(a) and (c), separate from . . . omissions liability" under Rule 10b-5(b).[27] These

---

22. *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (equating "manipulation" in the section 10(b) context with "artificially affecting market activity in order to mislead investors"); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976) ("Use of the word 'manipulative' is especially significant. . . . It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."); United States v. Mulheren, 938 F.2d 364, 368 (2d Cir. 1991) (assuming, without deciding, that manipulation may exist "where the purpose of [a] transaction is solely to affect the price of a security"); Pappas v. Moss, 393 F.2d 865, 869 (3d Cir. 1968) (stating that "the definition of 'deception' may vary with the circumstances" and finding deception in a board of directors' adoption of resolutions containing two material misrepresentations).

23. *Santa Fe*, 430 U.S. at 476; *see also Ernst*, 425 U.S. at 199 (stating that manipulation "is and was virtually a term of art when used in connection with securities markets"); NAGY ET AL., *supra* note 17, at 23 ("The term 'manipulative' has a specialized meaning . . . ."); STEINBERG, *supra* note 10, at 558 ("[T]he Supreme Court has construed that word as a term of art encompassing market operations.").

24. *Pappas*, 393 F.2d at 869; *see also* NAGY ET AL., *supra* note 17, at 23 ("Deception includes outright misrepresentations as well as statements that mislead by omission, even if such statements are literally true (so-called half-truths).").

25. *See, e.g.*, James D. Cox, Ernst & Ernst v. Hochfelder*: A Critique and an Evaluation of Its Impact upon the Scheme of the Federal Securities Laws*, 28 HASTINGS L.J. 569, 574-75 (1977) (exploring the meaning of these terms in arguing the ambiguity of section 10(b)); Elizabeth A. Nowicki, *10(b) or not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation*, 2004 COLUM. BUS. L. REV. 637, 678, 682-87 (defining key terms used in section 10(b) and Rule 10b-5 using a textualist approach); Steven R. Salbu, *Tipper Credibility, Noninformational Tippee Trading, and Abstention from Trading: An Analysis of Gaps in the Insider Trading Laws*, 68 WASH. L. REV. 307, 345-46 (1993) (arguing for a liberal definition of a "fraudulent scheme" concept in Rule 10b-5 cases).

26. United States v. Drobny, 955 F.2d 990, 997 (5th Cir. 1992).

27. Corsair Capital Partners v. Wedbush Morgan Sec., Inc., 24 F.App'x 795, 797 (9th Cir. 2001); *see also* Harris v. Union Elec. Co., 787 F.2d 355, 361 (8th Cir. 1986) (noting that the plaintiffs described two types of claims under Rule 10b-5: "disclosure fraud" and "transaction fraud").

three bases for liability under Rule 10b-5 must be individually alleged and proven.[28] Again, many of the important terms are undefined in the 1934 Act and beg for interpretation.[29] One thing can be said with some certainty, however. A mere breach of fiduciary duty does not satisfy this Rule 10b-5 element.[30]

Where allegations of manipulation or deception involve misstatements or omissions of material facts, litigants must contend with the meaning of the word "material." The judicially constructed definition of "material" under Rule 10b-5 consists of two alternative standards. A misstated or omitted fact is material if there is "a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision.[31] Alternatively, an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[32] Subsequent decisional law has construed these alternative standards in various contexts.[33]

2. "In Connection with" the Purchase or Sale of a Security.—Federal courts have advanced a number of legal standards defining the Rule 10b-5 requirement that the subject manipulation or deception occur "in connection with" the purchase or sale of a security.[34] The require-

---

28. "[W]here the sole basis . . . is alleged MISREPRESENTATIONS OR OMISSIONS, plaintiffs have not made out a market MANIPULATION claim under Rule 10B-5(a) and (c)." Lentell v. Merrill Lynch & Co., 396 F.3d 161, 177 (2d Cir. 2005) (citing Schnell v. Conseco, Inc., 43 F. Supp. 2d 438 (S.D.N.Y. 1999)).

29. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 n.20 (1976) (noting dictionary definitions for "device" and "contrivance").

30. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476-79 (1977).

31. BASIC Inc. v. LEVINSON, 485 U.S. 224, 231 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

32. *Id.* at 231-32 (quoting *TSC Indus.*, 426 U.S. at 449).

33. *See, e.g.*, Semerenko v. Cendant Corp., 223 F.3d 165, 178 n.6 (3d Cir. 2000) ("[I]n the context of an efficient market, 'the concept of materiality translates into information that alters the price of the firm's stock.'" (citing *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997)); United States v. Bingham, 992 F.2d 975, 976 (9th Cir. 1993) ("The government would have us adopt two per se rules, . . . that falsification of the identity of a buyer or seller of securities is always material, and . . . that officer or director status is always material. We decline the government's invitation to adopt such per se rules."); Garcia v. Cordova, 930 F.2d 826, 827 (10th Cir. 1991) ("[W]e find the asset appraisal information here to be immaterial as a matter of law due to its speculative and unreliable nature . . . ."). *See generally* Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131 (2003) (analyzing two hypothetical examples of possible insider trading and discussing numerous cases dealing with materiality).

34. *See* Jennifer O'Hare, *Preemption Under the Securities Litigation Uniform Standards Act: If It Looks Like a Securities Fraud Claim and Acts Like a Securities Fraud Claim, Is It a Securities*

ment is intended to be read broadly.[35] The U.S. Supreme Court most recently addressed this element in 2002, finding that "a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide" satisfies the "in connection with" requirement.[36] More than thirty years earlier, the Court had construed the "in connection with" element by stating that the identified manipulation or deception must at least "touch" the acquisition or disposition of a security.[37] Yet earlier, the Second Circuit had interpreted the "in connection with" requirement to encompass manipulative or deceptive conduct on which a reasonable investor would rely.[38] Other courts have embellished the definitional standards adopted in these cases.[39] For example, some courts are willing to find the requisite connection to a securities transaction if a proven misstatement of a material fact occurs in a medium calculated to reach investors.[40] Moreover, although there must be some relationship between the asserted manipulation or deception and a securities transaction, alleged misrepresentations need not relate to the investment value of a particular security to satisfy the "in connection with" element.[41]

> [T]he fraud in question must relate to the nature of the securities, the risks associated with their purchase or sale, or some other factor with similar connection to the securities themselves. While the fraud in question need not relate to

---

Fraud Claim?, 56 ALA. L. REV. 325, 329 (2004) (stating that "the courts have struggled with the meaning of the 'in connection with' element" and citing to scholars who have commented on this issue).

35. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); SEC v. Softpoint, Inc., 958 F. Supp. 846, 862 (S.D.N.Y. 1997).

36. SEC v. Zandford, 535 U.S. 813, 825 (2002).

37. *Superintendent of Ins.*, 404 U.S. at 12-13 ("The crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor."). This formulation has been criticized by some as being too broad a statement of the "in connection with" element. *See, e.g.*, Chem. Bank v. Arthur Andersen & Co., 726 F.2d 930, 942-43 (2d Cir. 1984).

38. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968).

39. *See, e.g.*, Rowinski v. Salomon Smith Barney Inc., 398 F.3d 294, 301 (3d Cir. 2005) (noting various standards adopted by different courts); McGann v. Ernst & Young, 102 F.3d 390, 392-96 (9th Cir. 1996) (discussing the compatibility of the *Texas Gulf* standard with later cases); Pelletier v. Stuart-James Co., 863 F.2d 1550, 1556 (11th Cir. 1989) (using the "touch" test); *Softpoint*, 958 F. Supp. at 862 (discussing numerous cases on the "in connection with" requirement); *see also* O'Hare, *supra* note 34, at 329-34 (analyzing various approaches to the "in connection with" requirement).

40. *E.g.*, Semerenko v. Cendant Corp., 223 F.3d 165, 176 (3d Cir. 2000); SEC v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993); *In re* Ames Dep't Stores Inc. Stock Litig., 991 F.2d 953, 965 (2d Cir. 1993); *In re* Leslie Fay Co. Sec. Litig., 871 F. Supp. 686, 697 (S.D.N.Y. 1995).

41. *E.g.*, *Zandford*, 535 U.S. at 820; Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 942 (3d Cir. 1985); A.T. Brod & Co. v. Perlow, 375 F.2d 393, 396-97 (2d Cir. 1967).

> the investment value of the securities themselves, it must have more than some tangential relation to the securities transaction.[42]

3. Scienter.—As a third core element of Rule 10b-5 claims, federal prosecutors, the SEC, and private plaintiffs must allege and prove that the defendant had scienter—a prescribed state of mind.[43] Mere negligence on the part of a defendant is not enough.[44] Moreover, allegations and proof of intentional misconduct, while sufficient to satisfy the scienter requirement, may not be necessary.[45] Although the U.S. Supreme Court has not yet ruled expressly on the specific required level of culpability, federal courts generally acknowledge that recklessness is sufficient to meet the scienter requirement under Rule 10b-5.[46] The claimant must establish that the defendant was aware of the "true state of affairs and appreciated the propensity of his misstatement or omission to mislead"[47] or acted with reckless disregard for the truth.[48] Essentially, scienter is the intent to manipulate or deceive.[49] This element of a Rule 10b-5 claim is difficult to allege and prove; evidence of scienter often is circumstantial.[50]

---

42. Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1026 (9th Cir. 1999).

43. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

44. *Id.* at 214.

45. Warren v. Reserve Fund, Inc., 728 F.2d 741, 745 (5th Cir. 1984). Some courts do reference intentionality or "purpose" in articulating the scienter requirement. *See, e.g., In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 427 (S.D.N.Y. 2003) ("The requisite state of mind, or scienter, in an action under Section 10(b) and Rule 10b-5, that the plaintiff must allege is a purpose to harm by intentionally deceiving, manipulating or defrauding.").

46. *E.g.*, Nathenson v. Zonagen Inc., 267 F.3d 400, 409 (5th Cir. 2001); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); Keirnan v. Homeland, Inc., 611 F.2d 785, 787 (9th Cir. 1980); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977); *see also* NAGY ET AL., *supra* note 17, at 110 ("[E]very federal court of appeals to confront the question has held recklessness sufficient for these purposes.").

47. PALMITER, *supra* note 11, at 283; *see also* AUSA Life Ins. Co. v. Ernst & Young, 206 F.3d 202, 221 (2d Cir. 2000) (criticizing the district court's opinion on the basis that it "inappropriately makes the scienter issue one of 'what did the defendant *want* to happen' as opposed to 'what could the defendant reasonably foresee as a potential result of his action'"); SEC v. Falstaff Brewing Corp., 629 F.2d 62, 77 (D.C. Cir. 1980) (holding that scienter exists when a defendant knows "the nature and consequences of his actions").

48. *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 535 (3d Cir. 1999); HAZEN, *supra* note 10, at 204, 256-61.

49. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); *In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 427 ("[T]he requisite state of mind for actionable securities fraud under Rule 10b-5 is the intent to deceive, manipulate or defraud, not merely the intent to utter an untruth."); PALMITER, *supra* note 11, at 282.

50. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983) (noting that proof of the requisite state of mind in a Rule 10b-5 action "is often a matter of inference from circumstantial evidence").

Criminal enforcement under Rule 10b-5 adds an important requirement. To be the subject of successful criminal prosecution under the 1934 Act, a violation must be willful.[51] Although the definition of the word "willful" in this and other contexts is uncertain,[52] recent decisional law under the 1934 Act and other federal statutes generally indicates that the government must at least show that the defendant acted with knowledge of the wrongfulness of his conduct under the law that he is accused of violating.[53]

---

51. 15 U.S.C. § 78ff(a) (Supp. II 2002). There is some debate over whether the scienter requirement, as an element of a Rule 10b-5 claim, collapses into or is synonymous with the willfulness requirement imposed on criminal prosecutions under Rule 10b-5.

> While civil actions require scienter and criminal actions require willfulness, it is unclear whether there is a meaningful distinction between the terms. In other words, it is debatable whether willfulness in criminal cases requires something above the ordinary scienter required in civil cases. At least one commentator has argued that "courts have interpreted the term 'willfully,' as used in [section] 32, to mean that only ordinary scienter is necessary to support a criminal conviction." This may be because "[section] 32 was drafted before [section] 10(b) was interpreted to require a showing of scienter." Until a court interpreting section 32(a) addresses the meaning of "willfully" in that provision, this question remains unresolved.

XueMing Jimmy Cheng et al., *Securities Fraud*, 41 AM. CRIM. L. REV. 1079, 1088-89 (2004) (footnotes omitted); *see also* Michael H. Dessent, *Joe Six-Pack*, United States v. O'Hagan, *and Private Securities Litigation Reform: A Line Must Be Drawn*, 40 ARIZ. L. REV. 1137, 1189 (1998) ("[W]illfulness is still defined as knowing conduct."). Professor Margaret Sachs answers the question simply, logically, and definitively: "The differentiated intent rule applies only if Congress expected courts to define these civil intent requirements less stringently than the willfulness requirement for criminal actions." Sachs, *supra* note 19, at 1054. Sachs argues Congress had such an expectation from its assumed knowledge of a 1933 Supreme Court case construing willfulness under the federal tax laws. *Id.* at 1054-55. In the interests of clarity, the willfulness requirement is set out separately from the scienter element in this Article.

52. *See* Spies v. United States, 317 U.S. 492, 497 (1943) (noting, in a federal income tax case, that "willful . . . is a word of many meanings, its construction often being influenced by its context."); Kelly Koenig Levi, *Figure This: Judging or Federal Fraud? A Proposal to Criminalize Fraudulent Judging and Officiating in the International Figure Skating Arena*, 25 HASTINGS COMM. & ENT. L.J. 97, 114 (2002) (observing, in a discussion of criminal claims under Rule 10b-5, that "[c]ourts . . . are not uniform in their determination of the level of conduct that satisfies 'willful.' Some conclude that specific intent is necessary, while others hold that recklessness is sufficient." (footnote omitted)).

53. *See, e.g.*, Ratzlaf v. United States, 510 U.S. 135, 149 (1994) (noting, in a federal money laundering case, that "the jury had to find he knew [that] the [conduct] in which he [was] engaged was unlawful."); Cheek v. United States, 498 U.S. 192, 201 (1991) (stating, in a federal tax evasion context, that "[w]illfulness . . . requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty"); United States v. Gross, 961 F.2d 1097, 1102 (3d Cir. 1992) ("[C]onviction on the false statements charges required the government to show that Gross acted with knowledge of the wrongfulness of his actions."); United States v. Peltz, 433 F.2d 48, 55 (2d Cir. 1970) (defining willfulness under section 32 of the 1934 Act as the defendant's realization that his actions were wrongful under the

> A defendant acts willfully when he acts intentionally and deliberately and his actions are not the result of an innocent mistake, negligence, or inadvertence. While proof of specific intent is not needed, the government must establish that the defendant had some evil purpose and intended to commit the prohibited act.[54]

B. Elements and Other Special Rules Applicable to Private Enforcement Actions

In addition to the core elements described in Part I.A, private plaintiffs claiming violations of Rule 10b-5 must have standing, prove three additional elements (reliance, causation, and damages), and meet certain additional requirements, some of which are applicable only in the class action setting. Although these private action elements and requirements were not at issue in the *Stewart* case, a brief treatment of them here better informs the reader as to the full panoply of options for legal action under Rule 10b-5 and provides additional foundation for the analysis in Part V.

Courts have imposed a standing requirement for private actions under Rule 10b-5, mandating that a plaintiff be an actual seller or purchaser of a security.[55] Forbearance—expressly deciding *not* to engage in a securities transaction as a result of conduct otherwise proscribed under Rule 10b-5, does not satisfy this element of proof.[56]

---

securities laws "and that the knowingly wrongful act involve a significant risk of effecting the violation that has occurred"); *see also infra* note 54 and accompanying text.

54. Cheng et al., *supra* note 51, at 1088 (footnotes omitted). Under the rule in certain cases, however, "[p]roof of a specific intent to violate the law is not necessary to uphold a conviction under § 32(a) of the Act, provided that satisfactory proof is established that the defendant intended to commit the act prohibited." United States v. Schwartz, 464 F.2d 499, 509 (2d Cir. 1972); *see also Peltz*, 433 F.2d at 54 ("A person can willfully violate an SEC rule even if he does not know of its existence."); James P. Hemmer, *Resignation of Corporate Counsel: Fulfillment or Abdication of Duty*, 39 HASTINGS L.J. 641, 644 (1988) (noting, in discussing criminal actions under Rule 10b-5, that "[a]lthough the term 'willful' has not been construed uniformly by the courts in criminal cases, generally that element will be satisfied if the defendant acted voluntarily and intentionally."); William B. Herlands, *Criminal Law Aspects of the Securities Exchange Act of 1934*, 21 VA. L. REV. 139, 148-49 (1934) (recognizing that criminal prosecution only requires "a realization on the defendant's part that he was doing a wrongful act"); Levi, *supra* note 52, at 114 (observing, in a criminal action under Rule 10b-5, that "[a]t minimum, most courts conclude that the defendant must have intended to do a wrongful act, but need not have intended to violate the law." (footnote omitted)). Some courts indicate that recklessness may be sufficient to support the willfulness requirement for criminal prosecutions under the federal securities laws. NAGY ET AL., *supra* note 17, at 839-40; Levi, *supra* note 52, at 114; Sachs, *supra* note 19, at 1053, 1055.

55. HAZEN, *supra* note 10, at 202; PALMITER, *supra* note 11, at 273; *see* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

56. *Blue Chip Stamps*, 421 U.S. at 730-31.

However, a defendant in a Rule 10b-5 action need not be a seller or purchaser.[57]

A private action plaintiff also must prove reliance on the alleged manipulative or deceptive conduct of the defendant.[58] Reliance often is equated with or described as "transaction causation"—but for the conduct of the defendant, the plaintiff would not have engaged in the subject purchase or sale of a security.[59] Certain common facts and circumstances give rise to a presumption of reliance, allowing the plaintiff to avoid affirmative proof of reliance as an initial burden.[60] These presumptions of reliance may be rebutted by a defendant, however, by a showing that refutes the rationale underlying the presumption.[61]

Loss causation is a further important element in private actions under Rule 10b-5. To satisfy this element, the plaintiff must prove that, but for the defendant's conduct, the plaintiff would not have suffered the claimed loss.[62] As recently construed by the U.S. Supreme Court, proof of this element requires proof by the plaintiff that an actual economic loss has been suffered by him.[63] It is not sufficient, for example, that the plaintiff allege and prove that securities purchased and held by her had an inflated price at the time they were purchased.[64]

A final element in private actions under Rule 10b-5 is proof of damages.[65] A plaintiff's recovery cannot exceed her actual damages.[66] There is no uniform means of calculating damages for Rule 10b-5

---

57. Baretge v. Barnett, 553 F.2d 290, 291 (2d Cir. 1977) ("[T]he rule does not require that defendant be the seller of the stock or that plaintiff have purchased the stock from defendant."); HAZEN, *supra* note 10, at 207.

58. *See supra* note 14 and accompanying text.

59. *E.g.*, Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 172 (3d Cir. 2001) ("Reliance, or transaction causation, establishes that but for the fraudulent misrepresentation, the investor would not have purchased or sold the security.").

60. BASIC Inc. v. LEVINSON, 485 U.S. 224, 245-47 (1988); Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-54 (1972).

61. *Basic*, 485 U.S. at 248-49; *see, e.g.*, *Newton*, 259 F.3d at 176; Joseph v. Wiles, 223 F.3d 1155, 1162-63 (10th Cir. 2000); Ross v. Bank South, N.A., 885 F.2d 723, 738 (11th Cir. 1989); Smith v. Ayres, 845 F.2d 1360, 1363 (5th Cir. 1988); Finkel v. Docutel/Olivetti Corp., 817 F.2d 356, 359 (5th Cir. 1987); Lipton v. Documation, Inc., 734 F.2d 740, 742-43 (11th Cir. 1984); Kramas v. Security Gas & Oil, Inc., 672 F.2d 766, 771 n.5 (9th Cir. 1982); *see generally* Joseph De Simone, Note, *Should Fraud On the Market Theory Extend to the Context of Newly Issued Securities?*, 61 FORDHAM L. REV. S151, S163 (1993) ("Later cases have interpreted the presumption of reliance recognized in *Affiliated Ute* as rebuttable.").

62. *See Newton*, 259 F.3d at 173 ("Loss causation demonstrates that the fraudulent misrepresentation actually caused the loss suffered.").

63. Dura Pharm., Inc. v. Broudo, 125 S. Ct. 1627, 1629, 1631-32 (2005).

64. *Id.* at 1631-32.

65. *Id.* at 1631.

claims.[67] Based on the facts and circumstances of his case, a plaintiff may seek (among other measures of damages) out-of-pocket damages,[68] contract damages,[69] or rescissory damages.[70] Rescission also may be an available remedy.[71]

---

66. 15 U.S.C. § 78bb(a) (2000) ("[N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."); PALMITER, *supra* note 11, at 287.

67. HAZEN, *supra* note 10, at 379; Lewis D. Lowenfels & Alan R. Bromberg, *Compensatory Damages in Rule 10b-5 Actions: Pragmatic Justice or Chaos?*, 30 SETON HALL L. REV. 1083, 1084 (2000) ("[T]here is no clear rule guiding the measure of damages under Rule 10b-5 and hence little predictability for counsel or the client.").

68. PALMITER, *supra* note 11, at 288. Out-of-pocket losses (damages actually and proximately caused by the defendant's violative conduct) are the most common measure of damages in Rule 10b-5 cases and typically are equal to the difference between the fair value of what the plaintiff received and the fair value of what the plaintiff would have received had there been no violative conduct. *Id.*; *see also* Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972); Ross v. Bank South, N.A., 885 F.2d 723, 742-43 (11th Cir. 1989); Huddleston v. Herman & MacLean, 640 F.2d 534, 555-56 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983).

69. PALMITER, *supra* note 11, at 288-89. Contract damages, also known as "benefit of the bargain" damages or referenced as damages calculated under a "loss of the bargain" rule, allow the plaintiff to recover his or her loss of the benefit of the bargain in contractual transactions. McMahan & Co. v. Wherehouse Entm't, Inc., 65 F.3d 1044, 1049 (2d Cir. 1995); Hackbart v. Holmes, 675 F.2d 1114, 1121-22 (10th Cir. 1982); Norte & Co. v. Huffines, 288 F. Supp. 855, 864 (S.D.N.Y. 1968), *modified*, 416 F.2d 1189 (2d Cir. 1969).

70. PALMITER, *supra* note 11, at 288. Rescissory damages attempt to put the plaintiff in the same financial position the plaintiff would be in if the transaction were rescinded by, for example, allowing a plaintiff-seller to recover the purchaser's profits (profit disgorgement) or a plaintiff-purchaser to recover the difference between her purchase and resale price. Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965); Speed v. Transamerica Corp., 135 F. Supp. 176, 186-94 (D. Del. 1955), *modified on another point and aff'd*, 235 F.2d 369 (3d Cir. 1956). Generally, rescissory damages only are appropriate when rescission has been made impossible (because, for example, stock bought or sold by the plaintiff has been resold). *See* Glick v. Campagna, 613 F.2d 31, 37 (3d Cir. 1979) ("If the defendant no longer owns the stock or it is otherwise unavailable because of a merger or other intervening event, then the court may award rescissory damages to place the plaintiff in the same financial position he would have been were it possible to return the stock.").

71. Flaks v. Koegel, 504 F.2d 702, 707 (2d Cir. 1974) ("The plaintiffs are . . . requesting . . . rescission and are simply seeking the recovery of the amounts paid for their stock. This is an appropriate remedy under sections 10(b) and 17 . . . ."); PALMITER, *supra* note 11, at 287; Robert B. Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 VAND. L. REV. 349, 367 (1984) ("When courts recognized the existence of private causes of action under rule 10b-5, most courts also acknowledged that a rule 10b-5 plaintiff could seek rescission instead of pursuing an action for damages."). Rescission is an equitable remedy that restores the parties to a transaction to their respective positions before the transaction. The remedy consists of unwinding the purchase and sale transaction between the parties, resulting in (a) a plaintiff-seller getting her stock back in exchange for the purchase price, or (b) a plaintiff-purchaser returning the stock she purchased in exchange for the purchase price she paid. *See Huddleston*, 640 F.2d at 554 ("Rescission is the avoidance or undoing of the transaction. Its purpose is to return the defrauded purchaser to the status quo ante; it contemplates the return of the injured party

Moreover, cases brought as private securities actions under federal law have their own set of applicable procedural rules. Over ten years ago, private actions (including class actions) brought under Rule 10b-5 became subject to significant additional requirements as a result of the enactment of the Private Securities Litigation Reform Act of 1995 (PSLRA).[72] Among these additional requirements are certain more stringent pleading standards. As a result of the PSLRA, for example, a private plaintiff alleging one or more material misstatements or misleading omissions in violation of Rule 10b-5 must specifically set forth, among other things, each statement or OMISSION and explain why any OMISSION is misleading.[73] Moreover, private plaintiffs bringing Rule 10b-5 claims now must allege facts "with particularity" that give rise to a "strong inference" that the defendant acted with the requisite scienter.[74] A damage cap also is provided in the PSLRA.[75]

C. Applicable Burdens of Proof

As a final general matter, it is significant to note that the burden of proof in criminal and civil actions under Rule 10b-5 is different. Criminal allegations in Rule 10b-5 actions, like those in other criminal prosecutions, must be proven by the government beyond a reasonable doubt.[76] Although no single, simple definition of the standard exists,[77] "[t]he standard of proof beyond a reasonable doubt means

---

to the position he occupied before he was wrongfully induced to enter the transaction."). Generally, rescission only is appropriate when the parties to the transaction are litigants and when their positions have not changed significantly since the transaction took place. *Id.* at 554-55.

72. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).

73. 15 U.S.C. § 78u-4(b)(1) (2000); *In re* Navarre Corp. Sec. Litig., 299 F.3d 735, 741-42 (8th Cir. 2002).

74. 15 U.S.C. § 78u-4(b)(2); *In re Navarre Corp. Sec. Litig.*, 299 F.3d at 745.

75. 15 U.S.C. § 78u-4(e); PALMITER, *supra* note 11, at 287. In any event, section 28(a) of the 1934 Act limits a plaintiff's recovery to "actual damages." 15 U.S.C. § 78bb(a); *see supra* note 66 and accompanying text.

76. *See* Apprendi v. N.J., 530 U.S. 466, 476-77 (2000) (tracing the requirement to roots in constitutional due process and rights of the accused); United States v. Gaudin, 515 U.S. 506, 510 (1995) (same).

77. *See, e.g.*, United States v. Hernandez, 176 F.3d 719, 728 (3d Cir. 1999) ("Reasonable doubt is not an easy concept to understand, and it is all the more difficult to explain."); Jessica N. Cohen, *The Reasonable Doubt Jury Instruction: Giving Meaning to a Critical Concept*, 22 AM. J. CRIM. L. 677, 682-88 (1995) (documenting the many different approaches to defining the standard); James Joseph Duane, *What Message Are We Sending to Criminal Jurors When We Ask Them to "Send a Message" with Their Verdict?*, 22 AM. J. CRIM. L. 565, 665 (1995) ("The words 'beyond a reasonable doubt' are notoriously obscure and are 'not self-defining for jurors.'"); Thomas V. Mulrine, *Reasonable Doubt: How in the World Is It Defined?*, 12 AM. U.J. INT'L L. & POL'Y 195, 213-25 (1997) (examining alternative definitions and recommending approaches to better defining the standard).

proof to a virtual certainty."[78] Civil actions under Rule 10b-5, whether public or private, need only be proven by the SEC or a private plaintiff by a preponderance of the evidence.[79] Although numerous definitions of this standard also exist,[80] in essence, "[t]he standard of preponderance of the evidence translates into more-likely-than-not."[81] Like the substantive elements, the burden of proof in a Rule 10b-5 action may impact the exercise of enforcement discretion, the determination of motions, and the final outcome in a case.

II. THE EVIDENCE: *UNITED STATES V. MARTHA STEWART*

This Part briefly reviews the evidence that led to the indictment of Martha Stewart for securities fraud under Rule 10b-5 and the facts adduced at trial that resulted in Stewart being acquitted of that charge by the judge on Stewart's motion. The summary presented in this Part is based solely on the Indictment and the court's opinion grant-

78. Kevin M. Clermont & Emily Sherwin, *A Comparative View of Standards of Proof*, 50 AM. J. COMP. L. 243, 251 (2002); *see also* Jackson v. Virginia, 443 U.S. 307, 315 (1979) ("[B]y impressing upon the factfinder the need to reach a subjective state of near certitude of the guilt of the accused, the standard symbolizes the significance that our society attaches to the criminal sanction and thus to liberty itself."); BLACK'S LAW DICTIONARY 1293-94 (8th ed. 2004) (DEFINING "reasonable doubt" as "[t]he doubt that prevents one from being firmly convinced of a defendant's guilt, or the belief that there is a real possibility that a defendant is not guilty"); Kimberly A. Pace, *Recalibrating the Scales of Justice Through National Punitive Damage Reform*, 46 AM. U. L. REV. 1573, 1618 (1997) ("The purpose of criminal law is to punish and deter (retributive), using a 'beyond a reasonable doubt' burden of proof, which MEANS that the prosecutor must prove that there is no reasonable question that the defendant committed the act."); Lawrence M. Solan, *Convicting the Innocent Beyond a Reasonable Doubt: Some Lessons About Jury Instructions from the* Sheppard *Case*, 49 CLEV. ST. L. REV. 465, 473 (2001) ("The expression 'proof beyond a reasonable doubt' is means for accomplishing an end—the requirement that a person should not be convicted unless the government proves its case to 'near certitude.'").

79. Herman & MacLean v. Huddleston, 459 U.S. 375, 387-88 (1983).

80. Matthew Stohl, *False Light Invasion of Privacy in Docudramas: The Oxymoron Which Must Be Solved*, 35 AKRON L. REV. 251, 254 n.13 (2002) ("'[P]reponderance of the evidence' is . . . subject to numerous definitions.").

81. Clermont & Sherwin, *supra* note 78, at 251; *see also* 5 C.F.R. § 1201.56(c)(2) (2005) (defining the standard to mean "[t]he degree of relevant evidence that a reasonable person, considering the record as a whole, would accept as sufficient to find that a contested fact is more likely to be true than untrue"); Cohen, *supra* note 77, at 693 (defining the standard as "more likely than not"); Vern R. Walker, *Restoring the Individual Plaintiff to Tort Law by Rejecting "Junk Logic" About Specific Causation*, 56 ALA. L. REV. 381, 460 (2004) ("Courts have interpreted this phrase as MEANING 'more likely than not,' 'probably true,' or 'more probably true than false.' The 'weight' or 'convincing force' or 'probative value' of the evidence supporting the finding must be 'greater than' the weight of evidence against the finding.").

ing Stewart's acquittal.[82] The summary is organized on the basis of the three core Rule 10b-5 elements, as set forth in Part I.

A. Manipulation or Deception

The government's case as to manipulation or deception, as expressed in its contentions in the Indictment, is built around four public statements made by or on behalf of Stewart in June 2002.[83] In each case, the Indictment asserts that the statements made constituted misrepresentations of material facts or that material facts omitted from those statements rendered the statements misleading.[84]

1. Statement Released on June 7, 2002 in the Wall Street Journal.—First, Stewart's legal counsel made a statement to the *Wall Street Journal* on Stewart's behalf on June 6, 2002 that was published by the *Wall Street Journal* on June 7, 2002.[85] The Indictment avers that this statement includes misrepresentations and conceals the material fact that Stewart had traded her ImClone shares after having been informed that ImClone president and chief executive officer Samuel Waksal and members of his family were selling or attempting to sell their ImClone shares.[86] The statement offers that Stewart sold her ImClone shares because of a "stop loss" order that authorized and directed the sale of her shares "if the stock ever went less than $60."[87] The Indictment asserts that the materiality of the alleged false and omitted facts derives from the fact that "STEWART's reputation, as well as the likelihood of any criminal or regulatory action against STEWART, were material to MSLO's shareholders because of the negative impact that any

---

82. These facts are, therefore, incomplete. The judge in the *Stewart* case expressly noted that her opinion did not include all of the facts presented at trial. United States v. Stewart, 305 F. Supp. 2d 368, 371 n.1 (S.D.N.Y. 2004). A summary of this kind optimally would be based on a thorough review of the trial transcript. However, a review of the Indictment and the court's opinion granting Stewart's motion of acquittal are sufficient for the purposes intended to be served by this Article, which assume the accuracy of the facts presented in these documents. In any event, there apparently were few disagreements between the prosecution and the defense on the facts proven at trial, other than the key dispute on the accuracy of Stewart's stated reason for selling her ImClone shares.

83. Indictment, *supra* note 2, ¶ 60. Both the Indictment and the court's opinion on Stewart's motion for acquittal reference three statements, but the information in these statements was publicly disseminated by Stewart four times. *Id.*

84. *Id.*

85. *Id.* ¶ 61.

86. *Id.*; *see id.* ¶¶ 15-17 (recounting the government's allegations regarding the concealed facts).

87. *Id.* ¶ 61 (quoting Chris Adams & Geeta Anand, *Martha Stewart Sold ImClone Shares—Timing Raises Questions, but There Is No Indication She Knew of FDA's Decision*, WALL ST. J., June 7, 2002, at B2).

such action or damage to her reputation could have on the company which [sic] bears her name . . . ."[88] In support of this materiality theory, the Indictment quotes a statement from the MSLO initial public offering prospectus (filed with the SEC in 1999)[89] and also notes an initial MSLO stock price drop after the public announcement of Stewart's sale of her ImClone shares.[90]

The court's opinion granting Stewart's motion for acquittal indicates that the government essentially proved the timing and content of the events relating to the June 7, 2002 *Wall Street Journal* article at trial.[91] Because the court's opinion on the motion for acquittal focuses on the issue of scienter, the court does not summarize in its opinion the evidence supporting the government's contention that this statement was, in fact, false or misleading.[92] As to materiality, the court notes the introduction into evidence of the initial public offering prospectus at trial[93] and finds the related facts to be as stated in the Indictment.[94] The court also finds that evidence was introduced at trial that substantiates the government's contention in the Indictment with respect to the effect of the first public disclosure of Stewart's December 2001 ImClone stock trade on MSLO's stock price.[95]

2. June 12, 2002 Press Release.—The second statement referenced in the Indictment is a June 12, 2002 public announcement that Stewart prepared and caused to be issued.[96] Again, the Indictment alleges that this statement contains false information and conceals the material fact that Stewart had traded her ImClone shares after having been told that Samuel Waksal and members of his family were selling or attempting to sell their ImClone shares.[97] This statement includes: more detailed facts about the alleged $60 "stop loss" order relating to Stewart's ImClone shares; information about related communications between Stewart and her stockbroker; and a representation by Stewart

---

88. *Id.* ¶ 57.

89. *Id.*

90. *Id.* ¶ 58.

91. *See* United States v. Stewart, 305 F. Supp. 2d 368, 371, 373 (S.D.N.Y. 2004) (setting forth the relevant facts that the jury could find from the evidence presented at trial).

92. For purposes of the motion, the court assumes that the statements are false. *Id.* at 371 n.1.

93. *Id.* at 372.

94. *Compare id.* at 371-74 (establishing the relevant facts for purposes of the securities fraud charges against Stewart), *with* Indictment, *supra* note 2, ¶¶ 57-64 (setting forth the factual allegations of the government).

95. *Stewart*, 305 F. Supp. 2d at 372-73.

96. Indictment, *supra* note 2, ¶¶ 62-63.

97. *Id.* ¶ 63.

that she did not have nonpublic information about ImClone when she sold her ImClone shares.[98] The materiality of the misrepresented and omitted facts in this June 12, 2002 statement is supported by the same allegations in the Indictment that support the materiality of the facts included in and omitted from the June 7, 2002 statement.[99]

In finding the facts adduced at trial, the court's opinion granting Stewart's motion for acquittal quotes the June 12, 2002 press release, substantiating the government's allegations about the date and substance of this statement.[100] Again, the court does not summarize in its opinion the evidence supporting the government's contention that the June 12, 2002 statement was false or misleading, since this contention was not at issue in Stewart's motion for acquittal.[101] The court's findings as to the materiality of the June 7, 2002 statement also apply to the materiality of the June 12, 2002 statement.[102]

3. June 18, 2002 Press Release Read by Stewart at a June 19, 2002 Conference.—The third statement referenced in the Indictment was prepared, approved, and caused to be issued by Stewart on June 18, 2002, on the eve of a speech scheduled to be given by Stewart on June 19th.[103] The occasion of the speaking engagement was a conference for securities analysts and investors.[104] According to the Indictment, Stewart's June 18, 2002 statement asserted that her June 12, 2002 statement explained the facts relating to the sale of her ImClone shares and that the sale of her ImClone shares was based on publicly available information.[105] The Indictment also avers that, in the June 18, 2002 statement, Stewart repeats her assertion that she sold her ImClone shares in accordance with a prior agreement with her broker that the shares be sold once the per share price of ImClone's common stock fell below $60 and states that she cooperated completely with the SEC and the U.S. Attorney's office.[106] Stewart read the June 18, 2002 statement at the June 19, 2002 conference.[107] According to the Indictment, the June 18, 2002 statement includes misrepresentations and conceals the same information that the June 7, 2002 and June 12,

98. *Id.*
99. *See supra* notes 88-90 and accompanying text.
100. *Stewart*, 305 F. Supp. 2d at 373-74.
101. The court does, however, note the facts in the press release that the government alleges to be false. *Id.* at 374 n.2.
102. *See supra* notes 93-95 and accompanying text.
103. Indictment, *supra* note 2, ¶¶ 64-65.
104. *Id.* ¶ 64.
105. *Id.*
106. *Id.*
107. *Id.* ¶ 65.

2002 statements conceal.[108] The government alleges that the facts included in and omitted from these statements are material on the same bases as those included in and omitted from the June 7, 2002 statement.[109]

In its opinion acquitting Stewart, the judge summarizes the facts found about the June 18, 2002 statement by noting that "[a]fter the close of business on June 18, 2002, Stewart issued a third statement that essentially repeated the June 12 statement, only adding that she was cooperating fully with the investigations."[110] Without addressing the truth or completeness of the June 18, 2002 press release,[111] the court also finds that it had been read by Stewart at the June 19, 2002 conference, "a forum for the executives of media corporations to update the investment community about their . . . financial health."[112] The opinion further states that the conference was "attended primarily by securities analysts and portfolio managers" and that "[i]nvestors were also present."[113] The materiality of the facts represented in and omitted from the June 18, 2002 public announcement may be assessed on the basis of the same facts found in the trial court's opinion that support the materiality of the June 7, 2002 statement.[114]

B. "In Connection with" the Purchase or Sale of a Security

The representations and allegations in the Indictment supporting the claim that any manipulative or deceptive conduct by Stewart was in connection with the purchase or sale of a security are somewhat skimpy and conclusory. The government's case emanates from the status of MSLO as a public company. The Indictment represents that "MSLO's common stock was listed and traded on the New York Stock Exchange . . . under the symbol 'MSO.'"[115] The Indictment further alleges that Stewart made or caused someone to make the four allegedly false and misleading statements relating to the sale of her ImClone shares "to defraud and deceive purchasers and sellers of MSLO common stock and to maintain the value of her own MSLO stock by

---

108. *Id.* ¶ 64; *see supra* notes 86 & 97 and accompanying text.

109. *See supra* notes 88-90 and accompanying text.

110. United States v. Stewart, 305 F. Supp. 2d 368, 374 (S.D.N.Y. 2004).

111. *See supra* notes 92 & 101 and accompanying text. The government's allegations as to the falsity of Stewart's various representations in the June 18, 2002 statement are, however, summarized in a footnote to the court's opinion. *Stewart*, 305 F. Supp. 2d at 375 n.3.

112. *Id.* at 374.

113. *Id.*

114. *See supra* notes 93-95 and accompanying text.

115. Indictment, *supra* note 2, ¶ 1.

preventing a decline in the market price of MSLO's stock,"[116] tying Stewart's asserted misrepresentations to purchase and sale transactions occurring in the public market for MSLO common stock.

In granting Stewart's motion for acquittal on the Rule 10b-5 charge, the trial judge notes and evaluates evidence that reflected the public company status of MSLO.[117] The court's opinion also references evidence that would allow a reasonable jury inference regarding the possible and actual impact that public statements and other publicly available information may have and have had on the public market for MSLO's common stock.[118] The court does not, however, find that the evidence adduced by the government at trial supports a reasonable jury inference that Stewart actually intended to deceive public investors in MSLO in making the June 7, 2002, June 12, 2002, and June 18, 2002 statements.[119] In fact, the court notes evidence to the contrary in the text of its opinion.[120]

C. Scienter

The evidence of scienter set forth in the Indictment is circumstantial. The essential story that the Indictment tells begins with the fact that Stewart, based on her knowledge and experience as a public company chairman and chief executive officer, licensed stock broker, and New York Stock Exchange director, knew of the effects that public statements have on a public company's stock price.[121] In addition, according to the Indictment, Stewart owned or had the option of acquiring a substantial percentage of MSLO's publicly traded common stock.[122] Based on that knowledge, experience, and stock position, the story continues, Stewart made false and misleading statements to the public about the reasons for the sale of her ImClone shares "in an effort to stop or at least slow the steady erosion of MSLO's stock price caused by investor concerns."[123] Moreover, Stewart allegedly made these statements "with the intent to defraud and deceive purchasers

---

116. *Id.* ¶ 60. The Indictment also alleges that Stewart's public misrepresentations were made "in an effort to stop or at least slow the steady erosion of MSLO's stock price caused by investor concerns." *Id.*

117. *See Stewart*, 305 F. Supp. 2d at 372 (noting that Stewart was the CEO of a public company and referencing the market price of MSLO's stock).

118. *Id.* at 372-73.

119. *Id.* at 370.

120. *See id.* at 375 n.4 (stating that a temporary rebound in MSLO's stock price is not evidence of Stewart's intent); *id.* at 377 (setting forth the court's interpretation of Stewart's statements at the June 19, 2002 conference).

121. Indictment, *supra* note 2, ¶¶ 1-2.

122. *Id.* ¶ 59.

123. *Id.* ¶ 60.

and sellers of MSLO common stock and to maintain the value of her own MSLO stock by preventing a decline in the market price of MSLO's stock."[124] The Indictment provides no additional, specific factual support for these allegations of purpose and intent.

The scienter-related facts set forth by the court in its opinion on Stewart's motion for acquittal are too numerous to set forth in full here,[125] but they parallel to a substantial extent the statement of the government's case in the Indictment. The inferences that the court finds permissible on the basis of those facts include:

- "that Stewart had a significant financial stake in MSLO";[126]
- "that Stewart was aware of the market price of her company's stock and of matters that could affect the price of that stock";[127]
- "that Stewart was aware of the importance of her reputation to the continued health of MSLO";[128]
- "that Stewart believed that the price of MSLO was falling in response to the negative publicity about the investigations" of Stewart in connection with the sale of her ImClone shares;[129] and
- "that some MSLO executives had concerns about the effect of the negative publicity on the company's business that were not immediately tied to the falling stock price."[130]

Importantly, however, the court finds that the prosecution's case was fundamentally flawed in that "the Government . . . offered no evidence that Stewart evinced a concern for the price of MSLO stock

---

124. *Id.*

125. Circumstantial evidence of intent typically derives from all of the facts and circumstances surrounding the defendant's actionable conduct that are presented and proven at trial. *See, e.g.*, United States v. Lenertz, 63 F.App'x 704, 709 (4th Cir. 2003) ("Fraudulent intent may be established by circumstantial evidence and by inferences deduced from facts and situations. Similarly, fraudulent intent may be inferred from the totality of the circumstances and need not be proven by direct evidence." (citations omitted)); United States v. Ross, 77 F.3d 1525, 1543 (7th Cir. 1996) ("An intent to defraud may be established by circumstantial evidence and by inferences from the facts and circumstances surrounding the scheme."); United States v. Aubrey, 878 F.2d 825, 827 (5th Cir. 1989) ("Proof of intent may arise by inference from all of the facts and circumstances surrounding a transaction."); United States v. One 1951 Chevrolet, 130 F. Supp. 777, 779 (D. Ky. 1955) ("Intent may be inferred as a matter of circumstantial evidence from the facts surrounding each case."). Accordingly, courts generally look to all of the significant facts proven in a case in determining scienter.

126. *Stewart*, 305 F. Supp. 2d at 371-72.

127. *Id.* at 372.

128. *Id.*

129. *Id.* at 373.

130. *Id.*

at any time during the relevant period"[131] and that no reasonable inferences of intent could be drawn in this regard from the evidence adduced at trial.[132]

III. CHARGING MARTHA STEWART WITH SECURITIES FRAUD: A GOOD THING?[133]

Should Martha Stewart have been charged with securities fraud? The answer to this question requires a review of the facts underlying Stewart's case in light of prosecutorial discretion (as informed by standards and guidance applicable to federal criminal prosecutions), the elements of a Rule 10b-5 charge, and (to a limited extent) the burden of proof in a criminal action. This analysis assumes that Stewart misrepresented the reason for selling her ImClone shares on December 22, 2001.

A. Factors in the Prosecutorial Decision to Charge

Prosecutors have the power and discretion to determine both whether and with what a possible criminal defendant will be charged.[134] Federal prosecutorial decisions to charge are subject to professional responsibility standards and U.S. Department of Justice (DOJ) guidelines, as well as formal and informal policies implemented by individual U.S. Attorneys offices.[135] From an ethical stand-

131. *Id.* at 376.

132. *Id.* at 376-78.

133. The trademark for "Good Things" is registered in the name of MSLO. U.S. Trademark Registration No. 2947861 (registered May 10, 2005), *available at* http://www.uspto.gov/main/trademarks.htm (follow "SEARCH trademarks" hyperlink; then follow "Structured Form Search (Boolean)" hyperlink; then search "Registration Number" field for "2947861"). MSLO also has applied for a service mark for "Good Things." U.S. Trademark Serial No. 78386149 (filed Mar. 17, 2004), *available at id.* (follow "SEARCH trademarks" hyperlink; then follow "Structured Form Search (Boolean)" hyperlink; then search "Serial Number" field for "78386149"). The trademark for "A Good Thing" was filed by another applicant and abandoned. U.S. Trademark Serial No. 78080819 (abandoned Sept. 6, 2002), *available at id.* (follow "SEARCH trademarks" hyperlink; then follow "Structured Form Search (Boolean)" hyperlink; then search "Serial Number" field for "78080819").

134. R. MICHAEL CASSIDY, PROSECUTORIAL ETHICS 13-14 (2005); Moohr, *supra* note 4, at 177 ("The power of the prosecutor to charge is two-fold; the power to indict or not . . . and the power to decide what offenses to charge."). The charges in an indictment are the result of a grand jury process. Use of the terms "prosecution" and "government" in this Article in reference to the charging in the *Stewart* case therefore generally includes both the grand jury and the U.S. Attorneys.

135. CASSIDY, *supra* note 134, at 14-24; Bennett L. Gershman, *A Moral Standard for the Prosecutor's Exercise of the Charging Discretion*, 20 FORDHAM URB. L.J. 513, 513 (1993) ("Various legal, political, experiential, and ethical considerations inform and guide the charging decision." (footnotes omitted)); Peter Krug, *Prosecutorial Discretion and Its Limits*, 50 AM. J.

point, Rule 3.8 of the American Bar Association's Model Rules of Professional Conduct (Model Rules) provides that "[t]he PROSECUTOR in a criminal case shall: (a) refrain from prosecuting a CHARGE THAT THE PROSECUTOR knows is not supported by probable cause."[136] Similarly, DR 7-103(A) of the American Bar Association's Model Code of Professional Responsibility states that "[a] public PROSECUTOR or other government lawyer shall not institute or cause to be instituted criminal CHARGES when he knows or it is obvious that the charges are not supported by probable cause."[137] Each of these professional conduct rules relies heavily on the elusive definition of probable cause.[138] All of the states and the District of Columbia have adopted a version of one of these rules.[139] Federal prosecutors are subject to the rules of the state or territory in which they practice.[140]

Supplemental to these professional responsibility and conduct rules, the DOJ has adopted Principles of Federal Prosecution (Principles) applicable to U.S. Attorneys that are set forth in the *U.S. Attorneys' Manual*.[141] The Principles include a number of rules applicable to prosecution and charging decisions. For example, under the Prin-

---

COMP. L. 643, 650-52 (2002) (outlining various sources of prosecutorial guidance). Prosecutors generally also are guided in their charging decisions by the American Bar Association Standards for Criminal Justice. STANDARDS FOR CRIMINAL JUSTICE § 3-3.9 (Am. Bar Ass'n, 3d ed. 1993), *available at* http://www.abanet.org/crimjust/standards/pfunc_blk.html; *see also* Krug, *supra*, at 651 (noting that certain professional organizations have adopted model charging standards); Ellen S. Podgor, *The Ethics and Professionalism of Prosecutors in Discretionary Decisions*, 68 FORDHAM L. REV. 1511, 1517-18 (2000) (discussing the charging guidelines developed by the ABA).

136. MODEL RULES OF PROF'L CONDUCT R. 3.8 (2000), *available at* http://www.abanet.org/cpr/mrpc/rule_3_8.html.

137. MODEL CODE OF PROF'L RESPONSIBILITY DR 7-103(A) (1980), *available at* http://www.abanet.org/cpr/ethics/mcpr.pdf.

138. CASSIDY, *supra* note 134, at 15-16; *see also* Brinegar v. United States, 338 U.S. 160, 175 (1949) ("'The substance of all the DEFINITIONS' OF PROBABLE CAUSE 'is a reasonable ground for belief of guilt.'" (quoting Carroll v. United States, 267 U.S. 132, 161 (1925)); BLACK'S LAW DICTIONARY, *supra* note 78, at 1239 (DEFINING "PROBABLE CAUSE" as "[a] reasonable ground to suspect that a person has committed . . . a crime"); George Fisher, *The Jury's Rise as Lie Detector*, 107 YALE L.J. 575, 579 (1997) ("The sworn testimony of a named witness who is not obviously delusional is all the PROSECUTOR needs to satisfy probable cause.").

139. Krug, *supra* note 135, at 652. In New York, where the *Stewart* case was prosecuted, the applicable professional conduct provision is Disciplinary Rule 7-103 of the New York Code of Professional Responsibility. NEW YORK STATE BAR ASS'N, LAWYER'S CODE OF PROFESSIONAL RESPONSIBILITY DR 7-103 (2002); *see also* People ex rel. Hirschberg v. Bd. of Sup'rs, 167 N.E. 204, 208 (N.Y. 1929) ("An action for malicious prosecution cannot be sustained if there was probable cause for the criminal prosecution, although it was maliciously commenced.").

140. 28 U.S.C. § 530B (2000) (known as the "McDade Amendment").

141. U.S. DEP'T OF JUSTICE, U.S. ATTORNEYS' MANUAL 9-27.000 (2002), *available at* http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm [hereinafter ATTORNEYS' MANUAL].

ciples, a federal prosecutor is required to have "probable cause to believe that a person has committed a Federal offense within his/her jurisdiction" before he or she can "[c]ommence or recommend prosecution."[142] This rule reinforces the ethical mandates of the Model Rules and the Model Code by using a "probable cause" standard. Moreover,

> [t]he attorney for the government should commence or recommend Federal prosecution if he/she believes that the person's conduct constitutes a Federal offense and that the admissible evidence will probably be sufficient to obtain and sustain a conviction, unless, in his/her judgment, prosecution should be declined because:
> 1. No substantial Federal interest would be served by prosecution;
> 2. The person is subject to effective prosecution in another jurisdiction; or
> 3. There exists an adequate non-criminal alternative to prosecution.[143]

The Principles also specify certain matters that a federal prosecutor should not consider when commencing or recommending prosecution.[144] Finally, "once the decision to prosecute has been made, the attorney for the government should charge, or should recommend that the grand jury charge, the most serious offense that is consistent with the nature of the defendant's conduct, and that is likely to result in a sustainable conviction."[145] Additional charges only should be

---

142. *Id.* at 9-27.200; *see* Bordenkircher v. Hayes, 434 U.S. 357, 364 (1978) ("[S]o long as the prosecutor has probable cause to believe that the accused committed an offense DEFINED by statute, the decision whether or not to PROSECUTE, and what charge to file or bring before a grand jury, generally rests entirely in his discretion.").

143. ATTORNEYS' MANUAL, *supra* note 141, at 9-27.220. The Principles go on to define each of the three reasons for declining to bring charges against a prospective criminal defendant. *Id.* at 9-27.230, 9-27.240, 9-27.250.

144. The relevant Principle states that

> [i]n determining whether to commence or recommend prosecution or take other action against a person, the attorney for the government should not be influenced by:
> 1. The person's race, religion, sex, national origin, or political association, activities or beliefs;
> 2. The attorney's own personal feelings concerning the person, the person's associates, or the victim; or
> 3. The possible affect of the decision on the attorney's own professional or personal circumstances.

Id. at 9-27.260; *see* Robert H. Jackson, *The Federal Prosecutor*, 31 J. AM. INST. CRIM. L. & CRIMINOLOGY 3, 5 (1940) (addressing the Second Annual Conference of United States Attorneys).

145. ATTORNEYS' MANUAL, *supra* note 141, at 9-27.300.

filed when, in the government attorney's judgment, the additional charges:

1. Are necessary to ensure that the information or indictment:
   a. Adequately reflects the nature and extent of the criminal conduct involved; and
   b. Provides the basis for an appropriate sentence under all the circumstances of the case; or
2. Will significantly enhance the strength of the government's case against the defendant or a codefendant.[146]

The Principles are supplemented from time to time by clarifying pronouncements, including internal memoranda from the U.S. Attorney General.[147] Also, individual offices of the U.S. Attorneys typically have their own guidelines, formal and informal.[148]

---

146. *Id.* at 9-27.320.

147. *E.g.*, Memorandum from John Ashcroft, Attorney Gen., U.S. Dep't of Justice, to All Federal Prosecutors, Department Policy Concerning Charging Criminal Offenses, Disposition of Charges, and Sentencing (Sept. 22, 2003), *available at* http://news.lp.findlaw.com/hdocs/docs/doj/ashcroft92203chrgmem.pdf ("It is the policy of the Department of Justice that, in all federal criminal cases [subject to a number of important exceptions], federal prosecutors must charge and pursue the most serious, readily provable offense or offenses that are supported by the facts of the case . . . .").

148. *See* Thomas E. Baker, *A View to the Future of Judicial Federalism: "Neither Out Far nor In Deep,"* 45 CASE W. RES. L. REV. 705, 749 (1995) ("The Department of Justice and the typical U.S. Attorney's Office have written prosecution guidelines, often labelled 'declination policies,' that describe principles for informed exercise of federal prosecutorial discretion."); Roger Conner et al., *The Office of U.S. Attorney and Public Safety: A Brief History Prepared for the "Changing Role of U.S. Attorneys' Offices in Public Safety" Symposium*, 28 CAP. U. L. REV. 753, 770 (2000) ("U.S. Attorneys' offices have guidelines for individual prosecutions."); Krug, *supra* note 135, at 650 ("[L]ocal PROSECUTORIAL offices have formally adopted written STANDARDS."). This decentralization has been in existence for decades. *See* Jackson, *supra* note 144, at 3-4 ("Your responsibility in your several districts for law enforcement and for its methods cannot be wholly surrendered to Washington . . . . It is an unusual and rare instance in which the local District Attorney should be superseded in the handling of litigation . . . ."). Office declination policies are not generally matters of public record. *See* Seigel & Slobogin, *supra* note 5, at 1110 n.12 ("Generally speaking, DOJ's prosecutorial guidelines, found in the United States Attorney's Manual, are open to the public, but office-by-office intake guidelines are not."); Fred C. Zacharias, *The Purposes of Lawyer Discipline*, 45 WM. & MARY L. REV. 675, 739 (2003) ("Nonenforcement policies ordinarily are kept secret."). Moreover, they are not fixed or firm rules under which prosecutors are bound to operate. *See* Michael Edmund O'Neill, *When Prosecutors Don't: Trends in Federal Prosecutorial Declinations*, 79 NOTRE DAME L. REV. 221, 240-42 (2003). While publicizing declination policies (or the reasons for declination in specific cases) would better inform the defense bar, defendants, and the public at large (potentially affording the public more confidence in the exercise of prosecutorial discretion), disclosure also may have undesirable impacts on criminal behavior by those attempting to avoid prosecution. *See* Michael Edmund O'Neill, *Understanding Federal Prosecutorial Declinations: An Empirical Analysis of Predictive Factors*, 41 AM. CRIM. L. REV. 1439, 1490-91 (2004). Similarly, formalizing fixed declination rules may have advantages and disadvantages. *See id.* at 1491-93.

These ethical standards and elements of professional guidance do not, however, provide dispositive guidance and are subject to significant interpretation.[149] Within the contours of these ethical and professional mandates, determinations of whether and what to charge are made based on the elements of applicable crimes and the then available facts,[150] in the context of broad, but not open-ended, prosecutorial discretion.[151] The constraints may be, among other things, constitutional, practical, and moral.[152] However, judicial chal-

---

149. *See* Laurie L. Levenson, *Working Outside the Rules: The Undefined Responsibilities of Federal Prosecutors*, 26 FORDHAM URB. L.J. 553, 558 (1999) ("[C]harging decisions take place in a gap in the rules—a gap intentionally left so that prosecutors can tailor justice. In order to fill the gap, prosecutors must apply both a practical sense of what is right and a moral standard." (footnote omitted)).

150. The resulting analyses are complex.

> If deciding how to charge a case were as simple as reading a statute and deciding whether its elements might apply to the defendant's behavior, then new prosecutors who have demonstrated their academic acuity should be equipped to handle the task. Experienced prosecutors know, however, that the charging decision is much more complicated. The difficulty comes in evaluating those factors that are not defined by statute, including the severity of the crime, the defendant's role in the crime, the defendant's past and possible future cooperation, injury to the victim, complexity in trying the case and the likelihood of success.

Id. at 559.

151. Wayte v. United States, 470 U.S. 598, 607 (1985) ("In our criminal justice system, the Government retains 'broad discretion' as to whom to prosecute."); Bordenkircher v. Hayes, 434 U.S. 357, 365 (1978) ("There is no doubt that the breadth of discretion that our country's legal system vests in prosecuting attorneys carries with it the potential for both individual and institutional abuse. And broad though that discretion may be, there are undoubtedly constitutional limits upon its exercise." (footnote omitted)); Gershman, *supra* note 135, at 513 ("The prosecutor's decision to institute criminal charges is the broadest and least regulated power in American criminal law. The judicial deference shown to prosecutors generally is most noticeable with respect to the charging function."); Krug, *supra* note 135, at 646 ("PROSECUTORS enjoy something close to a monopoly on the use of prosecutorial authority."); Daniel C. Richman & William J. Stuntz, *Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecution*, 105 COLUM. L. REV. 583, 608-09 (2005) ("Federal criminal law gives U.S. Attorneys and their assistants an enormous range of charging options: The scope of responsibility may be small, but jurisdiction is quite large. The combination means that federal prosecutors have both the time and the authority to do what they want . . . ."). Ellen Podgor ably summarizes the state of prosecutorial discretion.

> Prosecutorial discretion is a reality. Its existence has been consistently endorsed by the United States Supreme Court. Although Congress has recently extended the application of ethical rules to federal prosecutors, these rules do not directly supervise a prosecutor's discretionary decisions. Further, discretionary decisions will seldom reach a level of being "vexatious, frivolous, or in bad faith" to warrant a monetary award under the Hyde Amendment.

Podgor, *supra* note 135, at 1511-12 (footnotes omitted).

152. *Wayte*, 470 U.S. at 608 ("[T]he decision to prosecute may not be 'deliberately based upon an unjustifiable standard such as race, religion, or other arbitrary classification,' including the exercise of protected statutory and constitutional rights. It is appropriate to judge selective prosecution claims according to ordinary equal protection standards." (cita-

lenges to charging decisions are rarely successful.[153] Claims of bias or selective prosecution are particularly difficult to prove and are judicially disfavored.[154]

Moreover, compliance with the applicable ethical standards and professional guidance may not be actively monitored or enforced in practice. Both policing and enforcement, to the extent that either exists, are handled by the DOJ's Office of Professional Responsibility.[155] Significantly, defendants may not have a cause of action based on a prosecutor's violation of these applicable standards and guidelines.[156] In fact, the Principles themselves ordain this status.[157]

---

tion omitted)); Gershman, *supra* note 135, at 513 nn.3-5 (recognizing that prosecutorial discretion is constrained by legal, political, and experimental considerations in making charging decisions); *id.* at 522 ("My objective is . . . to provoke inquiry into the degree of moral confidence that a prosecutor should have before bringing criminal charges. My thesis is that the prosecutor should engage in a moral struggle over charging decisions, and should not mechanically initiate charges."); Leslie C. Griffin, *The Prudent Prosecutor*, 14 GEO. J. LEGAL ETHICS 259, 276 (2001) ("Prosecutions cannot be based upon race, religion, the exercise of rights, or other arbitrary classifications. It is difficult, however, for defendants to prove such constitutional violations." (footnote omitted)); Eric L. Muller, *Constitutional Conscience*, 83 B.U. L. REV. 1017, 1070-71 (2003) ("It is . . . well settled that a judge has the power to dismiss a criminal charge on the basis that it was unconstitutionally vindictive or selective." (footnotes omitted)).

153. *See* CASSIDY, *supra* note 134, at 20-24; Gershman, *supra* note 135, at 513 ("Limited constitutional and statutory constraints on charging are manifested in the presumption of prosecutorial good faith, and are reflected in the courts' acknowledgment that they lack the knowledge and expertise to supervise the prosecutor's exercise of discretion.").

154. *See* Oyler v. Boles, 368 U.S. 448, 456 (1962) ("[T]he conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation."); CASSIDY, *supra* note 134, at 23 ("[A] presumption of legality attaches to a prosecutor's charging decisions."); Muller, *supra* note 152, at 1071 ("Allegations of vindictive and selective prosecution are legion, but successful claims are exceedingly rare. Courts have also drastically limited the ability of criminal defendants to get discovery to support a claim of impermissibly selective prosecution." (footnote omitted)); Podgor, *supra* note 135, at 1518-19 ("Despite studies tending to show that prosecutors have exhibited bias in some of their charging decisions, courts have been reluctant to scrutinize the prosecutorial decision-making process." (footnote omitted)). In sum,

> "[t]o obtain discovery on a selective prosecution claim, a defendant must offer 'some evidence' of discriminatory effect and discriminatory intent." In order to prove selective prosecution, a defendant must prove that similarly situated individuals were not prosecuted and that he was singled out for prosecution on arbitrary grounds. The Court has set a high threshold of proof for these cases and gives a "presumption of regularity" to prosecutorial decisions . . . .

Griffin, *supra* note 152, at 276 (footnotes omitted).

155. Ellen S. Podgor, *Department of Justice Guidelines: Balancing "Discretionary Justice,"* 13 CORNELL J.L. & PUB. POL'Y 167, 186-89 (2004).

156. *Cf.* United States v. Caceres, 440 U.S. 741, 743-44 (1979) (refusing to allow exclusion of evidence obtained in violation of applicable Internal Revenue Service regulations). For a recent summary of cases on this point, see Podgor, *supra* note 155, at 189-94.

157. ATTORNEYS' MANUAL, *supra* note 141, at 9-27.150.

B. The Validity of the Stewart Securities Fraud Charge

Given the standards, guidance, and discretion applicable to prosecutorial charging decisions, the contours of applicable law, and the allegations of the Indictment, the decision to charge Stewart with securities fraud under Rule 10b-5 is apparently legally valid, although the analyses giving rise to this conclusion do raise some significant unanswered questions regarding prosecutorial discretion and important interpretive issues under each of the three core Rule 10b-5 elements that would need to be resolved at trial (and, perhaps, on appeal).[158] The nature of the conduct proscribed by Rule 10b-5 is broad and amorphous (and, in fact, is constantly evolving to include new undesired behaviors).[159] In this expansive and changing substantive law environment, the government had set forth allegations in the Indictment that could, if proven true, satisfy each of the three key elements of its case, and these allegations collectively were sufficient to constitute probable cause. Moreover, there is no evidence of any actual abuse of discretion in the charging decision.[160]

---

158. The charges based on these allegations have been described by some as unusual or "novel." United States v. Stewart, 03 Cr. 717 (MGC), 2004 U.S. Dist. LEXIS 789, at *5-*6; Moohr, *supra* note 4, at 179; *see* Stephen Bainbridge, Was Martha Stewart's Denial Material? The Problem with Count 9 (Dec. 4, 2003), http://www.professorbainbridge.com/2003/12/was_martha_stew.html (noting and endorsing the court's view that the Rule 10b-5 charge is "a bit of a stretch"); Henry Blodget, *The Charges Against Martha*, SLATE, Dec. 3, 2003, http://slate.msn.com/id/2091480/entry/2091866 (terming the Rule 10b-5 charge "controversial"). However, it is important to note that the court denied Stewart's motion to dismiss the Rule 10b-5 charge. *See* Brief for Defendant-Appellant Martha Stewart, at 16-17, United States v. Stewart, 04-3953(L)-cr (2d Cir. 2006), *available at* http://lawprofessors.typepad.com/whitecollarcrime_blog/files/Brief.pdf; Cynthia A. Caillavet, Comment, *From* Nike v. Kasky *to* MARTHA STEWART: First Amendment Protection for Corporate Speakers' Denials of Public Criminal Allegations, 94 J. CRIM. L. & CRIMINOLOGY 1033, 1039 (2004).

159. *See* Joan MacLeod Heminway, *Save* MARTHA STEWART? Observations About Equal Justice in U.S. Insider Trading Regulation, 12 TEX. J. WOMEN & L. 247, 256-61 (2003) (describing this pattern in insider trading litigation under Rule 10b-5); Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. S7 (1993) (a seminal work on Rule 10b-5's flexibility); Moohr, *supra* note 4, at 179 (noting, in the context of a discussion of criminal litigation under Rule 10b-5, that a pattern of "prosecutors raising new interpretations and courts acceding to them—leads to an incremental, but inexorable, expansion of the laws").

160. *Cf.* Kathleen F. Brickey, *Enron's Legacy*, 8 BUFF. CRIM. L. REV. 221, 256 (2004) (noting, after a review of corporate fraud cases including the *Stewart* case, that "there is no evidence of 'scapegoating' for the sake of expediency"). One commentator expressly refutes any allegation that Stewart was prosecuted because of her public-figure status.

> For example, some critical commentary in the wake of the indictment of Martha Stewart extolled the use of federal prosecutorial discretion to target a celebrity—as always assuming, for argument's sake, that the indictment satisfies the Principles of Federal Prosecution—because of the greater deterrent value such a prosecution provides. My view, and the implicit view of the United States Attorney who brought the indictment, is that Stewart's celebrity status is not a relevant differ-

1. Manipulation or Deception.—For example, the Indictment addresses whether Stewart's alleged misrepresentations as to the reason for the sale of her ImClone stock were actionable under Rule 10b-5 by detailing the four public statements made by Stewart and asserting that they are manipulative and deceptive because of their falsity.[161] Yet, it is not clear that Stewart's alleged misstatements about her personal stock sale were devices, schemes, artifices, acts, practices, or courses of business that are proscribed by Rule 10b-5.[162] This author has not found any reported case with facts substantially similar to those alleged in the Indictment. However, it is conceivable, based on the facts set forth in the Indictment, that Stewart's public statements were made to "artificially" affect the market for MSLO's stock, raising the possibility that her conduct was manipulative under Rule 10b-5.[163] Moreover, the allegations describe conduct (i.e., misrepresenting Stewart's reason for the ImClone stock sale) that could be deemed deceptive under existing decisional law, since the definition of "deception" is fact-specific.[164]

Further, to the extent the government's allegations of manipulation or deception rely on Stewart's misstatement of a material fact, the Indictment adequately alleges materiality.[165] Based on the facts alleged in the Indictment, a court or jury could find it substantially likely that a reasonable investor would find Stewart's alleged misrepresentations important in buying or selling MSLO securities. In the alternative, a court or jury could determine that it is substantially likely that Stewart's alleged misrepresentations would be viewed by MSLO investors as significantly altering the total mix of information made available to them.

It is not clear, however, that a court would or should find Stewart's alleged misstatements to be material under Rule 10b-5, even given the accuracy and completeness of the government's allegations in the Indictment.[166] The *Stewart* case involves the dissemination of noncorporate information—facts about an insider's personal trading

---

> ence and that her indictment must be justified without regard to it, notwithstanding the likely gain in general deterrence. (Whether in practice a potential defendant's notoriety exerts a subtle and improper influence is another matter. Certainly on occasion it does.)

Harry Litman, *Pretextual Prosecution*, 92 GEO. L.J. 1135, 1164-65 (2004) (footnotes omitted).

161. *See supra* Part II.A.

162. *See supra* Part II.A.

163. *See supra* notes 22-23, 25 and accompanying text.

164. *See supra* notes 22, 24-25 and accompanying text.

165. *See supra* notes 88-99, 109 and accompanying text.

166. *See* Bainbridge, *supra* note 158 (suggesting that materiality is problematic in the government's case). The Author further analyzes the materiality of Stewart's public state-

transaction involving the securities of another corporation, rather than facts about the issuer's financial condition, results of operations, business plans, or securities. The misrepresentation of personal facts by an insider is less likely to be material than the misstatement of corporate facts in that it may not be *substantially* likely that a *reasonable* investor would find personal facts about an insider—specifically, factual assertions supporting the insider's innocence of a crime—important in making an investment decision in the corporation's securities.[167] It is only because of Stewart's key executive status and strong identification with MSLO[168] that we even entertain an argument as to materiality, and those facts, taken alone, may not be sufficient to make out a case for materiality.[169] However, this materiality argument has not been tested and the personal-rather-than-corporate angle may better be addressed through questions about the "in connection with" element.

2. "In Connection with" the Purchase or Sale of a Security.—The Indictment raises even more interesting issues with respect to satisfaction of the "in connection with" requirement in Stewart's case. Do any alleged manipulative or deceptive activities conducted by Stewart have the requisite connection with a purchase or sale of securities such that a securities fraud charge under Rule 10b-5 is valid?

It is important to note at the outset that Stewart's criminal action is not based on manipulation or deception conducted by Stewart in

---

ments in a chapter of *Martha Stewart's Legal Troubles*, a forthcoming 2006 Carolina Academic Press book edited and co-authored by her.

167. *Id.* (questioning whether a reasonable investor would factor Stewart's statements into a decision to trade).

168. *See* Jeffrey Sagalewicz, Comment, *The Martha Duty: Protecting Shareholders from the Criminal Behavior of Celebrity Corporate Figures*, 83 OR. L. REV. 331, 334-37 (2004); Krysten Crawford, *Time to Cut Martha Loose?, Martha Stewart TV Show Is Suspended as Sentencing Date Nears. Can Other Martha Brands Survive?* CNN/MONEY, May 20, 2004, http://money.cnn.com/2004/05/19/news/midcaps/marthastewart; Susan C. Walker, *Martha Settling Down, Along with Company's Stock Price*, FOXNEWS.COM, Mar. 13, 2005, http://www.foxnews.com/story/0,2933,150206,00.html; *When the CEO Is the Brand, but Falls from Grace, What's Next?*, KNOWLEDGE@WHARTON, Apr. 7, 2004, http://knowledge.wharton.upenn.edu/index.cfm?fa=ViewArticle&ID=956 [hereinafter *CEO Is the Brand*].

169. Bainbridge, *supra* note 158. *But see* SEC v. Electronics Warehouse, Inc., 689 F. Supp. 53, 66 (D. Conn. 1988) ("An indictment for mail fraud of the president and founder of the issuing corporation was a fact that any reasonable investor would have considered important in making the decision to invest . . . ."); *In re* Franchard Corp., Securities Act of 1933 Release No. 4710, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,113, at 82,043-44 (July 31, 1964) (finding information about the wrongful conduct of a founder, key executive, and major stockholder to be material because, among other things, it is "germane to an evaluation of the integrity of his management" and it evidences "the possibility of a change in the control and management of registrant").

her capacity as a corporate officer of MSLO acting on its behalf to communicate matters to its security holders. Nor is the case about manipulation or deception committed against a party in privity with Stewart during the course of a securities transaction between Stewart and that other party. In those types of cases, the connection between the defendant's conduct and the purchase or sale of a security is clear.[170]

Rather, the claims in the *Stewart* case, as alleged, involve a corporate insider's misrepresentations of facts relating to a personal transaction made by Stewart in her individual capacity—the public sale of securities in another corporation, one in which she was *not* an insider. The Indictment alleges that this misrepresentation constituted fraud, manipulation, and deception *not* as to the purchasers of Stewart's ImClone stock, but instead as to those trading in securities of MSLO in the public market. In a case like this, the appropriate test to be used in applying the "in connection with" requirement is less clear.[171] Fundamentally, many of the approaches used by courts are grounded in the courts' views on the policies underlying the 1934 Act in general and Rule 10b-5 specifically.[172] The U.S. Supreme Court recently used these policies to explain its application of the "'coincidence' test" in interpreting the "in connection with" element.[173]

Yet, there is a connection between Stewart's statements about the reason for the sale of her ImClone shares and any market purchase or sale of MSLO securities made between the time of those statements and the times that they may have been corrected in the market. Any misstatements of a material fact by Stewart are connected to market purchases and sales of MSLO securities by a thin thread: the thread consisting of Stewart's strong identification with MSLO.[174] Under existing decisional law, it is possible that a judge or jury would find that this thin thread constitutes a sufficient connection. For example, Stewart consciously could abuse her identity with MSLO by making public statements to affect the public market for MSLO's stock and

---

170. *See, e.g.*, O'Hare, *supra* note 34, at 329 ("[I]n false corporate publicity cases, the courts have adopted a foreseeability test, asking if the company's 'assertions are made . . . in a manner reasonably calculated to influence the investing public.'"); *id.* ("[I]n a classic securities fraud case in which a person selling securities lies to the purchaser, there is no question that the fraud was 'in connection with' the purchase or sale of a security because the wrongdoer defrauded the victim into purchasing or selling his securities.").

171. *See id.* at 329-31 (describing various means used by courts in interpreting the "in connection with" element in less certain cases).

172. *Id.* at 330.

173. SEC v. Zandford, 535 U.S. 813, 821-24 (2002); *see also* O'Hare, *supra* note 34, at 331-34 (discussing the Supreme Court's analysis in *Zandford*).

174. *See supra* notes 168-169 and accompanying text.

deceive its investors such that her conduct coincides with securities transactions under the rule in *SEC v. Zandford*.[175] Moreover, publicly disseminated misstatements about a corporate executive whose personal identity, like that of Stewart, is effectively synonymous with the corporation's identity may necessarily "touch" on transactions in the corporation's securities under the rule in *Superintendent of Insurance v. Bankers Life & Casualty Co.*[176] In addition, under the rule in *SEC v. Texas Gulf Sulphur Co.*, a court or jury could find that Stewart's alleged misrepresentations constitute manipulative or deceptive conduct on which a reasonable investor would rely in making an investment decision.[177] As thus interpreted, it appears that the facts on the "in connection with" element adequately support the Rule 10b-5 charge.

3. Scienter.—Assuming Stewart manipulatively or deceptively misrepresented a material fact in connection with the purchase or sale of a security, it is essential that a prosecutor also assess whether her manipulation or deception was carried out with the requisite state of mind. Were her misstatements intentional, willful, or knowing? Were they merely reckless? How does this determination impact the decision to pursue Stewart's alleged misrepresentations in a criminal, rather than civil, action?

In the Indictment, the government essentially alleges that Stewart knew that public statements affect public company stock prices, that her ownership of a controlling interest in MSLO gave her a motive to positively affect MSLO's stock price, that Stewart intentionally misrepresented the reason for the sale of her ImClone shares to sustain the market price of MSLO's publicly traded common stock, and that Stewart intended to deceive MSLO investors in making those misstatements.[178] In making these allegations, the prosecution has set out its case in a manner, akin to motive and opportunity pleading in the civil litigation arena,[179] that satisfies the scienter element of Rule 10b-5.[180] At the same time, the allegations in the Indictment, by mentioning Stewart's intent to manipulate or deceive MSLO investors in connec-

175. *See supra* note 36 and accompanying text.

176. *See supra* note 37 and accompanying text.

177. *See supra* note 38 and accompanying text.

178. *See supra* notes 121-124 and accompanying text.

179. *See* O'Hare, *supra* note 34, at 335 n.64 (noting the acceptance of this pleading method in two circuits under the enhanced pleading requirements of the Private Securities Litigation Reform Act of 1995).

180. The Indictment allegations include facts analogous to some of those listed as evidence of scienter in *Greebel v. FTP Software, Inc.*, notably those involving financial self-interest. 194 F.3d 185, 206-07 (1st Cir. 1999).

tion with their purchases and sales of securities in the market, apparently satisfy the willfulness requirement necessary to a criminal prosecution.[181] Specifically, the Indictment alleges facts that, if proven true, may be deemed to establish that Stewart voluntarily acted with knowledge of the consequences of her actions and knew that her conduct was unlawful.[182]

4. Probable Cause and Other Prosecutorial Standards and Guidance.— The preceding analysis of the Indictment's allegations in relation to the elements of a criminal violation of Rule 10b-5 supports a conclusion that the government had probable cause to charge Stewart with securities fraud. Said another way, based on the facts alleged in the Indictment, the prosecution had a reasonable belief that Stewart committed securities fraud.[183] The federal grand jury that indicted Stewart found probable cause, resulting in the issuance of the Indictment.[184] Moreover, it is not obvious from the face of the Indictment that there is an absence of probable cause, nor is there any indication that the government otherwise possessed information negating the existence of probable cause to charge Stewart with securities fraud.

The prosecutorial guidelines set forth in the Principles (as described in Part III.A of this Article) provide a checklist in assessing the government's decision to prosecute Stewart on the facts stated in the

---

181. *See supra* notes 51-53 and accompanying text.

182. *See supra* notes 51-53 and accompanying text.

183. Although the allegations in the Indictment regarding scienter are not directly supported with specific facts, *see supra* Part II.C, they readily support a reasonable belief that Stewart committed securities fraud under Rule 10b-5. It does not matter, for purposes of the professional conduct rules governing prosecutorial charging decisions, that the prosecutor may not be able to prove the truth of the allegations at trial. Tracey L. Meares, *Rewards for Good Behavior: Influencing Prosecutorial Discretion and Conduct with Financial Incentives*, 64 FORDHAM L. REV. 851, 864 (1995) ("[T]he ethical rules do not clearly prohibit the prosecutor from deciding to charge an accused with offenses which the prosecutor has probable cause to believe are factually justified but which the prosecutor believes she probably will not be able to prove beyond a reasonable doubt at trial."); Kenneth J. Melilli, *Prosecutorial Discretion in an Adversary System*, 1992 BYU L. REV. 669, 680-81 ("PROBABLE CAUSE is little more than heightened suspicion, and it is not even remotely sufficient to screen out individuals who are factually not guilty.").

184. Gerstein v. Pugh, 420 U.S. 103, 117 n.19 (1975) ("[A]n indictment, 'fair upon its face,' and returned by a 'properly constituted grand jury,' conclusively determines the existence of probable cause . . . ."); Rodriguez v. Ritchey, 556 F.2d 1185, 1191 (5th Cir. 1977) ("[A]n indictment by a properly constituted grand jury conclusively determines the existence of probable cause . . . ."); Niki Kuckes, *The Useful, Dangerous Fiction of Grand Jury Independence*, 41 AM. CRIM. L. REV. 1, 19 (2004) ("[A] grand jury indictment is deemed a 'judicial' probable cause determination . . . ."); Andrew D. Leipold, *Why Grand Juries Do Not (and Cannot) Protect the Accused*, 80 CORNELL L. REV. 260, 299 (1995) ("Once the indictment is returned, the issue of probable cause is conclusively determined.").

Indictment. Although getting into the head of a prosecutor is as difficult as getting into the head of a criminal defendant, the Indictment indicates that the government believed that Stewart's conduct constitutes a criminal violation of Rule 10b-5,[185] and it is fair to assume that the government found it probable that the admissible evidence would be sufficient to obtain and sustain a conviction.[186] Moreover, in this post-Enron era, it is axiomatic that a prosecutor would find that a substantial federal interest would be served by charging a public figure chief executive officer with securities fraud.[187] Further, it is not clear that Stewart would have been subject to effective prosecution in another jurisdiction.[188]

However, a noncriminal alternative to prosecution did exist in the *Stewart* case.[189] An SEC enforcement action or administrative proceeding could have been brought against Stewart for violation of Rule 10b-5, subject to the scienter requirement and lower burden of proof applicable to civil proceedings.[190] Although the availability and adequacy of this alternative deserves careful scrutiny in the *Stewart* case, the prosecutor no doubt decided (on the basis of, for example, the difference in available remedies) that these alternatives were not "adequate," such that criminal prosecution was warranted.[191]

---

185. *See supra* note 143 and accompanying text. The Indictment is carefully and logically constructed to make out a valid securities fraud claim. *See supra* Part II.

186. *See supra* note 143 and accompanying text.

187. See supra note 143 and accompanying text. Among the factors supporting a conclusion that charging is in the federal government's interest are "[f]ederal law enforcement priorities" and "[t]he deterrent effect of prosecution," both of which would seem to relate to charging Stewart with securities fraud in June 2003, a time of governmental and public concern about securities fraud. ATTORNEYS' MANUAL, *supra* note 141, at 9-27.230.

188. *See supra* note 143 and accompanying text.

189. *See supra* note 143 and accompanying text.

190. *See supra* Part I.C (regarding applicable burdens of proof). Private actions, both under Rule 10b-5 and under state law theories, also could vindicate some of the policy goals underlying Stewart's criminal prosecution. In this regard, Ellen Podgor notes that

> [t]he prosecutor's discretionary power is magnified in the white collar crime context, where the characterization of conduct as criminal instead of tortious may be within the prosecutor's realm of decision-making. Whether a prosecutor should pursue wrongful conduct in an administrative arena or the criminal courts can also be a prosecutorial decision. Internal limits for prosecution used in a particular United States Attorney's Office may be the controlling factor in some of these decisions. Offices might use different threshold levels for proceeding with prosecutions.

Podgor, *supra* note 135, at 1519 (footnote omitted).

191. The *U.S. Attorneys' Manual* encourages prosecutors to consider "all relevant factors" in making the determination of whether a noncriminal alternative is adequate, but lists three factors specifically: "[t]he sanctions available under the alternative means of disposition"; "[t]he likelihood that an effective sanction will be imposed"; and "[t]he effect of non-criminal disposition on Federal law enforcement interests." ATTORNEYS' MANUAL,

There is a possibility, although it would be difficult to prove, that bias or improper influences played a role in the decision to bring the securities fraud charge against Stewart. For example, prosecutors may have been influenced by her sex or her political affiliation, her activities, or her beliefs.[192] Further, as always is possible, individuals involved in the prosecution of Stewart could have been influenced by their own personal feelings concerning Stewart[193] or by the possible effect of the charging decision on his or her own professional or personal circumstances.[194] Admittedly, these motivations would be difficult to substantiate, despite their importance.[195]

---

supra note 141, at 9-27.250. Given the close involvement of the SEC with the Department of Justice in the investigation and enforcement of possible violations of law relating to Stewart's sale of her ImClone shares, see, e.g., Press Release, U.S. Securities and Exchange Commission, SEC Charges Martha Stewart, Broker Peter Bacanovic with Illegal Insider Trading (June 4, 2003), *available at* http://www.sec.gov/news/press/2003-69.htm (in which the SEC "acknowledges the assistance of the U.S. Attorney's Office for the Southern District of New York and the Federal Bureau of Investigation in the investigation of this matter"), these and other factors likely were (or at least could have been) assessed.

192. *See* Heminway, *supra* note 159, at 251 (making similar and additional arguments about the SEC's decision to bring an enforcement action against Stewart for insider trading violations based on the sale of her ImClone shares); Blodget, *supra* note 158 ("[I]t is also plausible that Stewart . . . is being prosecuted primarily because she is famous and rich—prosecuting famous, rich executives being a sure-fire way to incite riotous public support, remedy the perceived mistakes of the past (toothless regulation and/or spineless enforcement), and advance careers."). *But see supra* note 144 and accompanying text.

193. *See* Heminway, *supra* note 159, at 277-78 (noting that the public may have mixed feelings about Stewart); Jeanne L. Schroeder, *Envy and Outsider Trading: The Case of* MARTHA STEWART, 26 CARDOZO L. REV. 2023, 2029 (2005) (describing how Stewart is both admired and disparaged by the public). *But see supra* note 144 and accompanying text.

194. *But see supra* note 144 and accompanying text.

195. In this regard, one scholar notes:

> The Supreme Court has affirmatively recognized judicial authority to review prosecutorial charging decisions in two situations: when the decision to increase charges was vindictive, and when the government improperly selected the defendant based on an impermissible classification. Whether the prosecutor acted vindictively or selected the defendant based on an unacceptable criterion focuses judicial review of prosecutorial conduct squarely on the motivations of the particular attorneys who made the decision. The Court's approach, however, avoided the hard issue of how to ascertain actual intent by adopting tests that made meaningful inquiry into the prosecutor's state of mind irrelevant for a vindictive prosecution claim, and almost impossible for a selective prosecution claim. Any judicial review of the decisions of whether to charge a particular person and which crime should be charged seems to be an area in which the prosecutor's thought process would be of paramount importance. The Court, however, has made intent essentially irrelevant, most likely because it recognized that asking prosecutors why they acted would be fruitless and perhaps even counterproductive.

Peter J. Henning, *Prosecutorial Misconduct and Constitutional Remedies*, 77 WASH. U. L.Q. 713, 734 (1999). The parallels between the difficulty of proving prosecutorial motivation in this context and the difficulty of proving scienter in the *Stewart* case are apparent.

Finally, the Stewart securities fraud charge apparently was the most serious offense that is consistent with Stewart's alleged conduct,[196] and the prosecution likely found that the charge would result in a sustainable conviction.[197] The government's decision to bring additional charges in the Indictment are similarly subject to prosecutorial standards, guidance, and discretion but are not the subject of this Article.[198]

IV. SAVING MARTHA STEWART: A GOOD THING?[199]

As a means of analyzing the value of the *Stewart* case as an example of a specific type of securities fraud under Rule 10b-5 and already having established that the charges against Stewart apparently are valid, this Part examines the judge's decision to grant Stewart's mo-

---

196. See supra note 145 and accompanying text. The seriousness of an offense typically is measured by reference to the severity of the penalties imposed upon violators. ATTORNEYS' MANUAL, *supra* note 141, at 9-27.300 ("The 'most serious' offense is generally that which yields the highest range under the sentencing guidelines."). Under current law, the penalties for criminal violations of Rule 10b-5 include fines of up to $5,000,000, imprisonment for up to twenty years, or both. 15 U.S.C. § 78ff(a) (Supp. II 2002). As an alternative under current law, one might bring a federal criminal action under the securities fraud provision included in the Sarbanes-Oxley Act of 2002, which provides for fines as provided under the federal criminal law, or imprisonment of up to twenty-five years, or both. 18 U.S.C. § 1348 (Supp. II 2002). Current penalties for conspiracy include fines as provided under federal criminal law or imprisonment for up to five years, or both. *Id.* § 371 (2000). Obstruction of justice currently carries possible penalties that include fines as provided under the federal criminal law, imprisonment of up to five years, or both. *Id.* § 1505. The crime of making false statements subjects defendants to penalties that include fines as provided under the federal criminal law, imprisonment of up to five years, or both. *Id.* § 1001(a). Finally, perjury is punishable by fines as provided under the federal criminal law, imprisonment of up to five years, or both. *Id.* § 1621. Fines for individuals under Title 18 of the United States Code are provided for in § 3571(b). None apparently would be in excess of the $5,000,000 fine imposed by 15 U.S.C. § 78ff(a) (Supp. II 2002).

197. *See supra* note 145 and accompanying text.

198. It is fair to note, however, that overcharging may have occurred in the *Stewart* case. *See* Seigel & Slobogin, *supra* note 5, at 1108-09.

> Overcharging is systemic. It flows from the structure of criminal law that facilitates this charging practice because many categories of crime contain lesser-included offenses and because the same criminal conduct is described by different overlapping offenses. The practice of overcharging also flows from the discrepancy between the amount of information the prosecutor has at the outset of the case and what the prosecutor expects to be able to prove at trial. Because the prosecutor may not have as much information as she would like at the charging stage, she may often believe that it is in her best interests to charge the defendant with the most serious and as many crimes at the outset of the case to preserve options for prosecution at a later time.
>
> Overcharging is also due in part to an abhorrence of losing that is central to prosecutorial culture.

Meares, *supra* note 183, at 868-69.

199. *See supra* note 133.

tion for a judgment of acquittal under Rule 29 of the Federal Rules of Criminal Procedure (Rule 29) before submitting the case to the jury.[200] This judicial decision is important for at least two reasons. First, by granting the motion for acquittal before the jury's deliberations, the court denied the jury the opportunity to find the facts and decide the case. Because the government cannot appeal Stewart's judgment of acquittal (since an appeal would subject Stewart to double jeopardy),[201] this action by the judge completely foreclosed criminal securities fraud liability on the part of Stewart for her alleged misrepresentations. Second, the court's opinion granting Stewart's acquittal has substantive import (as a ruling on the scienter element of a Rule 10b-5 claim) for, among others, practitioners (including transactional lawyers, as well as litigators in the public and private spheres), judges, Congress, and the SEC. This Part summarizes the procedural law applicable to the court's opinion acquitting Stewart of securities fraud and analyzes the court's opinion in light of that law.

---

200. Motions for a judgment of acquittal are made under Rule 29, which provides:

> After the government closes its evidence or after the close of all the evidence, the court on the defendant's motion must enter a judgment of acquittal of any offense for which the evidence is insufficient to sustain a conviction. The court may on its own consider whether the evidence is insufficient to sustain a conviction. If the court denies a motion for a judgment of acquittal at the close of the government's evidence, the defendant may offer evidence without having reserved the right to do so.

FED. R. CRIM. PROC. 29(a). The rule goes on to note:

> The court may reserve decision on the motion, proceed with the trial (where the motion is made before the close of all the evidence), submit the case to the jury, and decide the motion either before the jury returns a verdict or after it returns a verdict of guilty or is discharged without having returned a verdict. If the court reserves decision, it must decide the motion on the basis of the evidence at the time the ruling was reserved.

FED. R. CRIM. PROC. 29(b).

201. Fong Foo v. United States, 369 U.S. 141, 143 (1962).

> Federal Rule of Criminal Procedure 29 enables the trial judge upon her own initiative or motion of the defense to direct a judgment of acquittal in a criminal trial at any time prior to the submission of the case to the jury. Once the judgment of acquittal is entered, the government's right of appeal is effectively blocked by the Double Jeopardy Clause of the U.S. Constitution, as the only remedy available to the Court of Appeals would be to order a retrial. No matter how irrational or capricious, the district judge's ruling terminating the prosecution cannot be appealed.

Richard Sauber & Michael Waldman, *Unlimited Power: Rule 29(a) and the Unreviewability of Directed Judgments of Acquittal*, 44 AM. U. L. REV. 433, 433-34 (1994) (footnote omitted); *see* U.S. CONST. amend. V ("[N]or shall any person be subject for the same offence to be twice put in jeopardy of life or limb . . . .").

A. *Law Applicable to a Judgment of Acquittal*

A Rule 29 motion asks for acquittal of a criminal defendant because the government has failed to prove its case.[202] To decide a Rule 29 motion:

> [T]he evidence is to be viewed in the light most favorable to the prosecution and, in appraising its sufficiency, it is not necessary that the trial court or this court be convinced beyond a reasonable doubt of the guilt of the defendant. The question is whether there is substantial evidence upon which a *jury* might justifiably find the defendant guilty beyond a reasonable doubt.[203]

Accordingly, the court's role is to determine whether the prosecution's evidence, taken as a whole, could support a conviction by a "reasonable" jury.[204] A conviction requires proof of each element of the

---

202. *See supra* note 200.

203. White v. United States, 279 F.2d 740, 748 (4th Cir. 1960); *see also* United States v. O'Keefe, 825 F.2d 314, 319 (11th Cir. 1987); United States v. Stirling, 571 F.2d 708, 726 (2d Cir. 1978); United States v. Robinson, 71 F. Supp. 9, 10 (D.D.C. 1947).

> Another way of expressing the same rule is that the motion for judgment of acquittal must be granted when the evidence, viewed in the light most favorable to the government, is so scant that the jury could only speculate as to the defendant's guilt, and is such that a reasonably-minded jury *must* have a reasonable doubt as to the defendant's guilt.

United States v. Fearn, 589 F.2d 1316, 1321 (7th Cir. 1978) (citation omitted).

204. Although numerous statements of the Rule 29 standard exist, one trial court summarized:

> In passing upon a motion for a judgment of acquittal, the trial judge must determine whether upon the evidence, giving full play to the right of the jury to determine credibility, weigh the evidence, and draw justifiable inferences of fact, a reasonable mind might fairly conclude guilt beyond a reasonable doubt. If he concludes that upon the evidence there must be such a doubt in a reasonable mind, he must grant the motion; or, to state it another way, if there is no evidence upon which a reasonable mind might fairly conclude guilt beyond reasonable doubt, the motion must be granted. But if a reasonable mind might fairly have a reasonable doubt or might fairly not have one, the case is for the jury.

United States v. Hufford, 103 F. Supp. 859, 860 (M.D. Pa. 1952). Recent Second Circuit opinions state the standard in a more succinct manner. *See, e.g.*, United States v. Chen, 378 F.3d 151, 158 (2d Cir. 2004) (citing the formulation of the standard in Jackson v. Virginia, 443 U.S. 307, 319 (1979)); United States v. Thorn, 317 F.3d 107, 132 (2d Cir. 2003) (same); United States v. Jackson, 335 F.3d 170, 180 (2d Cir. 2003) ("Under Rule 29, a district court will grant a motion to enter a judgment of acquittal on grounds of insufficient evidence if it concludes that no rational trier of fact could have found the defendant guilty beyond a reasonable doubt."); United States v. Reyes, 302 F.3d 48, 52 (2d Cir. 2002) ("[A] district court can enter a judgment of acquittal on the grounds of insufficient evidence only if, after viewing the evidence in the light most favorable to the prosecution and drawing all reasonable inferences in the government's favor, it concludes no rational trier of fact could have found the defendant guilty beyond a reasonable doubt.").

crime beyond a reasonable doubt.[205] The court must take pains not to appropriate the jury's task.[206] Rule 29 motions are rarely granted.[207]

B. The Correctness and Efficacy of the Judge's Acquittal of Stewart

In rendering its February 27, 2004 opinion acquitting Stewart of securities fraud, the court acknowledges that its role is to "determine whether the record evidence could reasonably support a finding of guilt beyond a reasonable doubt."[208] The standard that the court initially cites as applicable to its decision requires the court to "determine whether upon the evidence, giving full play to the right of the jury to determine credibility, weigh the evidence, and draw justifiable inferences of fact, a reasonable mind might fairly conclude guilt beyond a reasonable doubt."[209] Interestingly, this formulation of the applicable decisionmaking standard is relatively old and potentially more defendant-friendly than others,[210] although the court twice re-

---

205. *See* United States v. Ubl, 472 F. Supp. 1236, 1237 (N.D. Ohio 1979) ("[T]he trial judge must determine whether the Government has presented sufficient evidence from which reasonable jurors could conclude guilt beyond a reasonable doubt. This standard must be applied to each and every element of the offense charged . . . ."); *see also supra* notes 76-78 and accompanying text.

206. United States v. Guadagna, 183 F.3d 122, 129 (2d Cir. 1999) ("[T]he court must be careful to avoid usurping the role of the jury."); Curley v. United States, 160 F.2d 229, 233 (D.C. Cir. 1947) (stating that the determination of reasonable doubt "is the jury's function, provided the evidence is such as to permit a reasonable mind fairly to reach either of the two conclusions"). The *Curley* court explains the need for restraint in the context of the role of judge and jury in a criminal trial.

> If the judge were to direct acquittal whenever in his opinion the evidence failed to exclude every hypothesis but that of guilt, he would preempt the functions of the jury. Under such rule, the judge would have to be convinced of guilt beyond peradventure of doubt before the jury would be permitted to consider the case. That is not the place of the jury in criminal procedure. They are the judges of the facts and of guilt or innocence, not merely a device for checking upon the conclusions of the judge.

Id.

207. United States v. Stewart, 305 F. Supp. 2d 368, 370 (S.D.N.Y. 2004); Amy Baron-Evans, *An Important but Modest Check on Prosecutorial Overreaching and Wrongful Conviction*, BOSTON B.J. at 31, 31 (Sept.-Oct. 2004) ("Judges agonize over RULE 29 motions and deny them if the question is at all close. In the rare cases in which the motion is granted, the rulings are not hidden, but are made in open court, often in published opinions, and appear on the docket." (citation omitted)); Paul L. Hoffman, *The "Blank Stare Phenomenon": Proving Customary International Law in U.S. Courts*, 25 GA. J. INT'L & COMP. L. 181, 187 (1995-1996) ("Rule 29 motions are rarely granted even in cases where they should be, because most judges prefer to send the case to the jury rather than risk criticism for acquitting the defendant.").

208. *Stewart*, 305 F. Supp. 2d at 370 (quoting *Jackson*, 443 U.S. at 319).

209. *Id.* (quoting *Curley*, 160 F.2d at 233).

210. More recent articulations of the Rule 29 standard in the Second Circuit use fewer

states the applicable standard in a less slanted manner.[211] It is unclear from the opinion whether any particular articulation of the applicable decisionmaking standard influenced the court's decision to acquit Stewart of securities fraud, but it is possible that her initial statement of the standard played a role in the outcome of the case.

In its opinion granting Stewart's motion for an acquittal, the court focuses its analysis on the scienter element of the government's case. The court finds that the facts adduced by the prosecution at trial fall short of proving beyond a reasonable doubt that Stewart acted with the scienter required under Rule 10b-5 and the willfulness required by section 32(a) of the 1934 Act.[212] Specifically, the court concludes that a jury would have to speculate in order to find beyond a reasonable doubt that Stewart acted with the required state of mind—the intent to manipulate the price of MSLO's stock or deceive MSLO's investors.[213]

Two aspects of the court's opinion, taken together, raise questions about the correctness of its holding and undercut its efficacy. First (and most importantly), the court fails to adequately explain and support its view of the difference between a "justifiable inference" (which a jury is permitted to make in finding guilt beyond a reasonable doubt),[214] and speculation (which a jury is not permitted to do in finding guilt beyond a reasonable doubt).[215] Moreover, in light of the weakness of the court's reasoning on the scienter element, the court should have been more inclusive in the matters addressed in its opin-

---

qualifying adjectives and adverbs. *See, e.g., Chen*, 378 F.3d at 158 (omitting the requirement that the trier of fact's findings of guilt beyond a reasonable doubt be fair); *Jackson*, 335 F.3d at 180 (same); *Thorn*, 317 F.3d at 132 (same); *Reyes*, 302 F.3d at 52 (same). These recent versions of the Rule 29 standard may make it more difficult for a judge to acquit a defendant on a Rule 29 motion.

211. *See Stewart*, 305 F. Supp. 2d at 370.

212. *Id.*

213. *Id.*

214. *See* United States v. Hufford, 103 F. Supp. 859, 860 (M.D. Pa. 1952) (noting that the jury has the right to, among other things, draw justifiable inferences of fact).

215. *See* Galloway v. United States, 319 U.S. 372, 395 (1943) ("[T]he essential requirement is that mere speculation be not allowed to do duty for probative facts, after making due allowance for all reasonably possible inferences favoring the party whose case is attacked."); Sunward Corp. v. Dun & Bradstreet, Inc., 811 F.2d 511, 521 (10th Cir. 1987) ("Although a jury is entitled to draw reasonable inferences from circumstantial evidence, reasonable inferences themselves must be more than speculation and conjecture."); Daniels v. Twin Oaks Nursing Home, 692 F.2d 1321, 1326 (11th Cir. 1982) ("[A] jury will not be allowed to engage in a degree of speculation and conjecture that renders its finding a guess or mere possibility."); *Curley*, 160 F.2d at 232 ("The jury may not be permitted to conjecture merely, or to conclude upon pure speculation . . . .").

ion.[216] Specifically, the court's exclusive focus on scienter ignores alternative bases for an acquittal—other questionable elements of the government's case against Stewart—including most importantly whether Stewart's misrepresentations were made in connection with a purchase or sale of securities (a matter to which the court refers, albeit indirectly, in its opinion).[217] The collective impact of these attributes of the opinion is that the court shortcuts its reasoning in a manner that makes its decision appear somewhat goal-oriented, weakening its impact, if not its validity.

1. Reasonable Inferences or Speculation?—The court's opinion relies on a critical distinction—that between justifiable inferences from evidence adduced at trial and speculation. In its opinion, the court sets forth the facts that it believed the government proved at trial and the reasonable inferences that the jury could have made from those facts.[218] In analyzing the facts and inferences in light of the scienter element, the court finds that the prosecution did not prove its case.[219] The court then finds "that a reasonable juror could not, without resorting to speculation and surmise, find beyond a reasonable doubt

---

216. One might logically question why a judge should be more thorough when her decision is not reviewable. Certainly, a judge in this circumstance does not fear any reputational or other disadvantage associated with being overruled by a higher court. However, the reasoning supporting a judge's decision on a Rule 29 motion should not depend on whether the decision is subject to review. It is a serious matter in our criminal justice system when a judge preempts or nullifies a jury determination, a determination that vindicates the public's right to fair enforcement of the law. *See* United States v. Scott, 437 U.S. 82, 100 (1978) (noting the public's deprivation of an important right when a case is taken away from the jury); *cf.* Sauber & Waldman, *supra* note 201, at 452-56 (noting that truth-seeking, uniformity, consistency, fairness, and careful consideration are important criminal justice objectives that are not well-served by allowing judges to grant Rule 29 motions on a nonappealable basis before jury deliberations). Because the appellate review that normally would protect the public's rights in a criminal prosecution is unavailable for judgments of acquittal granted before jury deliberations, the judiciary should be encouraged to provide conclusive and well-documented support for a Rule 29 judgment of acquittal. The production of a well-reasoned, complete opinion should improve the quality of both the judge's decisionmaking and any resulting law. *See* Suzanne Ehrenberg, *Embracing the Writing-Centered Legal Process*, 89 IOWA L. REV. 1159, 1185-86 (2004) (contending that the process of constructing a thoroughly researched, comprehensive opinion creates better precedent).

217. *See supra* Part I.A.2. This Author also has questions, as did Stewart, about whether Stewart's alleged misrepresentations are material under the tests set forth in *TSC Industries* and *Basic*. *See supra* notes 31-33 & 166-169 and accompanying text. Because the substance of the materiality issue was neither addressed nor alluded to by the court in its opinion, *see infra* note 256, and is not otherwise necessary to the critique of the court's opinion offered in this Article, it shall be left for another day.

218. *See supra* Part II.C.

219. *See supra* notes 131-132 and accompanying text.

that Stewart's purpose was to influence the market in MSLO securities."[220]

The court's reasoning in support of its opinion is conclusory. For example, in response to each of the government's arguments that an inference of scienter could be drawn from the context in which Stewart's statements were made, the court merely restates the proven facts and concludes that they did not constitute evidence of, or allow reasonable inferences as to, Stewart's intent.[221] The court does not describe the logical disconnect between the evidence adduced at trial, including permissible inferences drawn from that evidence, and the state of mind requisite to a criminal violation of Rule 10b-5. The court's approach is particularly disquieting as applied to Stewart's fourth misrepresentation—the reading of the June 18, 2002 press release at the June 19, 2002 conference attended by analysts and investors—which the court classifies as "a closer question."[222] The facts adduced by the government at trial as to this fourth alleged misrepresentation appear to be sufficient to establish beyond a reasonable doubt that Stewart could foresee the potential market impact of a misstatement.[223] Under the circumstances, the judge may have been too quick to grant Stewart's motion for acquittal, which could have been decided under Rule 29 on an appealable basis after a jury determination of guilt.[224]

Given the magnitude of the court's decision to grant Stewart an acquittal and the acknowledged closeness of the question as to whether the government may have proven its case against Stewart on

---

220. United States v. Stewart, 305 F. Supp. 2d 368, 376 (S.D.N.Y. 2004). By focusing on "purpose" in this statement, the *Stewart* court also may be criticized for ignoring (without explanation) decisional law on scienter that rejects this definition of scienter (preferring, instead, to focus on what the defendant reasonably could foresee as the consequence of her misstatement). *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 672 (5th ed. 2006); *supra* notes 47-48 and accompanying text. Yet, the *Stewart* court is not the only court to define scienter by reference to the defendant's purpose. *See In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 427 (S.D.N.Y. 2003) (focusing on the purpose behind the deceptive acts).

221. The court twice indicates that the evidence would better include proof of intent if Stewart had a more active role in arranging for the dissemination of her statements. *See Stewart*, 305 F. Supp. 2d at 376-77. Yet in each case, Stewart chose to make her statements in forums that were easily accessible or targeted toward investors, including MSLO investors. The court even noted that Stewart verbally acknowledged the likely interest of the audience of analysts and investors in her statements about the sale of her ImClone shares. *Id.* at 377.

222. *Id.* Apparently, the more stringent burden of proof applicable to criminal actions played a key role in the judge's holding. *Id.* at 369-70; *see* Caillavet, *supra* note 158, at 1040-41 (recognizing that Stewart could be held civilly liable for her statements).

223. *See supra* notes 121-130 and accompanying text.

224. *See supra* note 200.

the scienter element (at least with respect to the statements made at the June 19, 2002 conference), the court's reasoning is missing important definitional links, links that would help the court establish and clarify her view of the difference between justifiable, rational, or reasonable inferences and mere speculation, as each relate to this case. Admittedly, the distinction is a difficult one.[225] Fortunately, some guidance in this regard is provided by courts in other jurisdictions and contexts.

For example, in the civil context,[226] one federal district court roots the definition of a "reasonable inference" in logic and probability.

> The line between a reasonable inference that may permissibly be drawn by a jury from basic facts in evidence and an impermissible speculation is not drawn by judicial idiosyncracies. The line is drawn by the laws of logic. If there is an experience of logical probability that an ultimate fact will follow a stated narrative or historical fact, then the jury is given the opportunity to draw a conclusion because there is a reasonable probability that the conclusion flows from the proven facts.[227]

Another federal circuit court defines "reasonable" inferences as "inferences which may be drawn from the evidence without resort to speculation."[228] The same court notes that a civil case should be decided by the court, rather than a jury, "[w]hen the evidence is so one-sided as to leave no room for any reasonable difference of opinion as to how the case should be decided."[229] Of course, "[w]hen the record

---

225. *See* Sunward Corp. v. Dun & Bradstreet, Inc., 811 F.2d 511, 521 (10th Cir. 1987) ("The line between 'reasonable inferences' and mere speculation is impossible to define with any precision.").

226. Although one generally would not want to apply procedural observations from civil cases in the criminal context, they do serve a limited use here. In this regard, it is significant to note that "the power to direct an acquittal developed as a corollary to the directed verdict in civil cases." Sauber & Waldman, *supra* note 201, at 434.

227. Tose v. First Pa. Bank, N.A., 648 F.2d 879, 895 (3d Cir. 1981); *accord* MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 640 (11th ed. 2004) (defining "inference" as, among other things, "the act of passing from one proposition, statement, or judgment considered as true to another whose truth is believed to follow from that of the former").

228. Hauser v. Equifax, Inc., 602 F.2d 811, 814 (8th Cir. 1979); *accord* United States v. Galbraith, 20 F.3d 1054, 1057 (10th Cir. 1994) ("An inference must be more than speculation and conjecture to be reasonable."). An alternative definition of "reasonable inferences" that was articulated more recently in the U.S. Court of Federal Claims, provides that "such inferences as are born of common experience or are the product of a decision maker's special expertise—are within the rightful province of the decider of fact to make." Snyder v. Sec'y of Dep't of Health & Human Serv., 36 Fed. Cl. 461, 466 (Fed. Cl. 1996).

229. Admiral Theatre Corp. v. Douglas Theatre Co., 585 F.2d 877, 883 (8th Cir. 1978); *accord* Sip-Top, Inc. v. Ekco Group, Inc., 86 F.3d 827, 830 (8th Cir. 1996).

contains no proof beyond speculation to support the verdict, judgment as a matter of law is appropriate."[230] Yet, "[a]n inference is not unreasonable simply because it is based in part on conjecture, for an inference by definition is at least partially conjectural,"[231] but "an inference is unreasonable if it is at war with uncontradicted or unimpeached facts."[232] Although these statements regarding reasonable inferences were made in a civil law context and are not binding on the *Stewart* court, they are nevertheless instructive. Among other things, they indicate that the meaning of the word "speculation" may be critical to a court's decision on a Rule 29 motion.

What, then, constitutes speculation? "Speculation" is defined as "an act or instance of speculating."[233] Among other things, to "speculate" is "to take [something] to be true on the basis of insufficient evidence."[234] The concept of speculation often is tied to the related concepts of conjecturing,[235] guessing,[236] or surmising[237] when it is found in decisional law under Rule 29 (including in the *Stewart* opinion).[238]

Based on these definitions and a review of the court's opinion, it is not clear that the court in the *Stewart* case properly understood the nature of a reasonable inference or was able to properly separate inferences from speculation. The proven facts and permissible inferences noted by the court in its opinion constitute "substantial evidence"[239] of Stewart's criminal intent; certainly, one would not

---

230. *Sip-Top*, 86 F.3d at 830.

231. Daniels v. Twin Oaks Nursing Home, 692 F.2d 1321, 1326 (11th Cir. 1982).

232. Helene Curtis Indus., Inc. v. Pruitt, 385 F.2d 841, 851 (5th Cir. 1967).

233. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY, *supra* note 227, at 1199.

234. *Id.*

235. *Id.* at 263 (defining the verb "conjecture" as "to arrive at or deduce by conjecture" and defining the noun "conjecture" as an "inference from defective or presumptive evidence" or "a conclusion deduced by surmise or guesswork").

236. *Id.* at 555 (defining the verb "guess" as "to form an opinion of from little or no evidence").

237. *Id.* at 1258 (defining the verb "surmise" as "to form a notion of from scanty evidence").

238. *See, e.g.*, United States v. Pinckney, 85 F.3d 4, 7 (2d Cir. 1996) ("[A] conviction cannot rest on mere speculation or conjecture."); Ford Motor Co. v. McDavid, 259 F.2d 261, 266 (4th Cir. 1958) ("[I]t is the duty of the court to withdraw the case from the jury when the necessary inference is so tenuous that it rests merely upon speculation and conjecture."); United States v. Stewart, 305 F. Supp. 2d 368, 376 (S.D.N.Y. 2004) ("[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."); United States v. Batka, 724 F. Supp. 350, 352 (E.D. Pa. 1989) ("There was no need for the jury to guess or speculate . . . .").

239. *See supra* note 203 and accompanying text.

term them "scant."[240] The fact that the evidence is largely circumstantial is not a barrier to a jury determination.[241]

More particularly, one cannot say that, given this evidence, the government failed to prove, beyond a reasonable doubt, facts that, when taken in the light most favorable to the prosecution and combined with the inferences cited as permissible by the court, constitute the requisite state of mind for a criminal proceeding under Rule 10b-5. The adduced facts and permissible inferences[242] referenced by the court apparently would permit a reasonable juror to fairly conclude that the government proved its case on scienter beyond a reasonable doubt without the jury having to speculate, conjecture, guess, or surmise. Specifically, a reasonable juror could fairly find that Stewart's significant personal, financial interest in the price of MSLO's securities,[243] together with her knowledge of the market for MSLO securities,[244] her known effect on MSLO,[245] her direction of inaccurate and misleading statements to investors (among others),[246] and her acknowledgement of the interest of those investors in the content of those statements[247] prove beyond a reasonable doubt that Stewart intended to manipulate the market for MSLO's securities or deceive MSLO's investors.[248] The government's proof arguably established beyond a reasonable doubt that there is a reasonable probability that Stewart's alleged misstatement was made with the requisite intent.[249] Although it would be helpful if the jury also had before it evidence that Stewart was concerned about the market price of MSLO securities at the time she was making these statements, that evidence is not an

240. *See supra* note 203 and accompanying text.

241. United States v. Fermin, 32 F.3d 674, 678 (2d Cir. 1994) ("[A] jury may always base its verdict on reasonable inferences from circumstantial evidence."); *see* United States v. Serpico, No. 99 CR 570, 2001 U.S. Dist. LEXIS 9523, *12 (N.D. Ill. July 9, 2001), *rev'd on other grounds*, 320 F.3d 691 (7th Cir. 2003) ("[A]lthough 'a conviction may be based solely on reasonable inferences from circumstantial evidence, a conviction cannot rest on mere speculation or conjecture.'" (quoting United States v. Pinckney, 85 F.3d 4, 7 (2d Cir. 1996)).

242. *See supra* notes 126-130 and accompanying text.

243. *See supra* note 126 and accompanying text.

244. *See supra* note 127 and accompanying text.

245. *See supra* note 128 and accompanying text.

246. United States v. Stewart, 305 F. Supp. 2d 368, 373, 376-77 (S.D.N.Y. 2004) (citing the facts as to the public release of each of Stewart's statements and the court's analysis of those facts); *see also supra* note 113 and accompanying text.

247. *Stewart*, 305 F. Supp. 2d at 377.

248. This does not mean that Stewart actually would have been or should be convicted of securities fraud if the matter were brought before a jury for decision. That is neither the standard for granting a judgment of acquittal under Rule 29 nor the subject of this Article.

249. *See supra* notes 126-130 and accompanying text.

essential component to the government's case.[250] The court should have left the securities fraud charge to the jury for decision.[251]

2. Omission of an Analysis of the "In Connection with" Element.— One also might then question whether the court most effectively conveyed its decision on the motion to acquit by focusing its analysis exclusively on the scienter element. Presumably, the court's decision to focus on this element reflects its determination that scienter is the only—or at least the clearest—aspect of the case that the government did not prove beyond a reasonable doubt.[252]

Yet, interestingly, the same speculation that the court found necessary to the government's case on scienter also provides an important link between Stewart's public representations about the sale of her ImClone shares and the purchase and sale of MSLO's securities. In other words, if the government failed to prove beyond a reasonable doubt that Stewart "evinced a concern for the price of MSLO stock at any time during the relevant period,"[253] that same failure makes it more difficult, if not impossible, for a reasonable juror to fairly conclude that Stewart's statements had the requisite connection with market transactions in MSLO's securities under Rule 10b-5. Specifically, absent factual proof or justifiable inference that Stewart was worried about the price of MSLO's publicly traded stock, the government may not have proven beyond a reasonable doubt to a rational juror that Stewart's misrepresentations about her private transaction in Im-

250. The court found that the government's evidence did, in fact, give rise to a permissible inference that, in general, executives at MSLO were concerned about the market price of MSLO's stock price during the period in which Stewart's public statements were made. *Stewart*, 305 F. Supp. 2d at 373. The facts found by the court also indicate Stewart's status as an executive of MSLO. *Id.* at 372.

251. Substantiating this judgment is the fact that the court, in sifting through the evidence adduced at trial, appears to impermissibly weigh that evidence in ruling on Stewart's Rule 29 motion, substituting its judgment on the meaning and relative weight of the facts proven at trial for that of the jury. *See, e.g., id.* at 377 (interpreting and weighing against each other certain statements made by Stewart at the June 19th conference). A case in another circuit calls this practice into question. *See* United States v. Olbres, 61 F.3d 967, 973 (1st Cir. 1995) (noting the jury's right to choose between reasonable alternatives from the available evidence).

252. There is a possibility that the court chose to rely on the scienter element for other reasons. For example, the court may have chosen to focus on scienter for strategic reasons related to legal, reputational, or other benefits associated with this approach. Certainly, the court was aware that, in deciding the Rule 29 motion before the jury had deliberated on the Rule 10b-5 charge, its decision would not be reviewable by a higher court. The timing of the court's choice also may have been influenced by the court's decision to focus on scienter. *See infra* note 287 and accompanying text.

253. *Stewart*, 305 F. Supp. 2d at 376.

Clone's securities "coincide" with[254] or "touch"[255] the public sales of MSLO's stock. Although Stewart's Rule 29 motion argued that any misrepresentation made by Stewart was not in connection with the purchase or sale of MSLO's securities, there is no analysis of the "in connection with" element in the court's opinion.[256]

Judgments that the court makes in its opinion also could have been used by the court in attacking the government's case with respect to the "in connection with" requirement. Most importantly, in its reasoning on the scienter element, the court expressly acknowledged the weakness of any connection between Stewart's alleged misrepresentations and the public market for MSLO's securities.[257] The court noted that Stewart's public statements "lack[ed] a direct connection to the supposed purpose of the alleged deception"[258] and were "only circuitously related to the purpose of deceiving investors in MSLO securities."[259] To the extent that the nexus between Stewart's public statements and any alleged manipulative or deceptive purpose or intent that she may have had in making them is tenuous, the connection between her statements and any related trading in MSLO's securities necessarily would be similarly weak. If Stewart had a manipulative or deceptive intent, she would have had to intend the necessary consequence of her actions[260]—namely, public trading in MSLO's securities resulting from her public statements. Accordingly, the judge could have strengthened her decision by broadening the scope of inquiry to include a discussion of and decision on the "in connection with" element.

V. OBSERVATIONS ON THE MARTHA STEWART SECURITIES FRAUD PROSECUTION

The foregoing analyses of the securities fraud charge brought against Martha Stewart and aspects of the opinion acquitting Stewart

---

254. *See supra* note 36 and accompanying text.

255. *See supra* note 37 and accompanying text.

256. The court specifically notes that Stewart also raised Rule 29 arguments on the materiality of her public statements and the satisfaction of the "in connection with" element of a Rule 10b-5 action. *Stewart*, 305 F. Supp. 2d at 378 n.5. In a somewhat paradoxical exercise of judicial restraint, the court expressly declined to address these issues because it deemed them "not necessary." *Id.*

257. *Id.* at 378.

258. *Id.*

259. *Id.*

260. *See* SEC v. Falstaff Brewing Corp., 629 F.2d 62, 77 (D.C. Cir. 1980) ("[N]o area of the law—not even the criminal law—demands that a defendant have thought his actions were illegal. A knowledge of what one is doing and the consequences of those actions suffices.").

of that charge highlight a number of interesting and potentially important aspects of a Rule 10b-5 case brought against a corporate insider on the basis of misrepresentations made by the insider about personal facts. Although the *Stewart* case was a criminal action, it nevertheless sends messages about both criminal and civil claims under Rule 10b-5, including class actions. This Part consolidates important points from the analyses in Parts III and IV and sets forth key observations regarding those analyses.[261]

A. Rule 10b-5 Allegations Based on Misrepresented Personal Facts

A legally valid criminal charge or civil claim under Rule 10b-5 for misrepresentations relating to an insider's personal facts is possible,[262] even if unusual.[263] Facts satisfying each of the key elements of a Rule 10b-5 claim—activities, including misrepresentations of material fact, constituting manipulation or deceit, conducted in connection with the purchase or sale of a security, with scienter—may be alleged with respect to misstatements about personal matters or transactions.[264] However, the lack of a perfect fit between the elements of a Rule 10b-5 claim (as defined under existing decisional law) and misrepresentations of wholly noncorporate facts complicates both the construction of adequate allegations in an indictment or complaint[265] and the determination of probable cause in a criminal action.[266] Principal questions relate to: whether the misstated personal information about the insider is "material";[267] whether the insider's statements about private, individual facts are made "in connection with" a purchase or sale of

---

261. Part V focuses on descriptive observations, but the need for normative observations based on these analyses is apparent. Should prosecutors pursue criminal actions under Rule 10b-5 on the basis of public misstatements made by an insider about her personal affairs? Should an insider be found guilty or liable for violating Rule 10b-5 for lying to the public about personal transactions conducted in her individual capacity? The answers to these questions also are provocative and important; the conclusion in Part I only begins to explore these areas. Ultimately, these and other similar inquiries would involve resolution of tensions between the application of Rule 10b-5 in this unusual context and, for example, First Amendment and (in the event of material nondisclosures) privacy issues. In fact, Stewart attempted to raise First Amendment issues in her trial, but was prohibited from doing so by the court. *See* United States v. Stewart, 03 Cr. 717 (MGC) 2004 U.S. Dist. LEXIS 789, at *4 (S.D.N.Y. Jan. 26, 2004); *see also* Caillavet, *supra* note 158, at 1039-40.

262. *See generally supra* Part III.B.

263. *See supra* note 158.

264. *See supra* Part III.B.

265. *See supra* Part III.B.1-3. Complaints in private actions would have to meet the more stringent pleading requirements included in the PSLRA. *See supra* notes 72-74 and accompanying text.

266. *See supra* Part III.B.4.

267. *See supra* Part III.B.1.

securities;[268] and whether the insider made the subject misrepresentations with the requisite scienter under Rule 10b-5[269] and, if applicable, criminal intent under section 32(a) of the 1934 Act.[270] Moreover, in private actions, there likely would be difficult questions as to reliance (or transaction causation)[271] and loss causation[272] and as to the adequate pleading of scienter.[273] At the heart of these questions is the corporate insider's ability to manipulate the market for the corporation's securities or deceive the investors in those securities with misstated or undisclosed personal information. The investing public must strongly identify the insider with the corporation in order for the insider to have this ability.[274] Absent a strong insider-corporate identity (which is relatively rare, but not unique),[275] a Rule 10b-5 claim alleging that the insider manipulated the market for the corporation's securities or deceived the corporation's investors by misrepresenting personal information will fail to satisfy the requisite elements.

B. Difficulties of Proof in Rule 10b-5 Cases Based on Misrepresented Personal Facts

The complexities involved in validly and adequately alleging violations of Rule 10b-5 for insider misrepresentations of personal facts translate into significant difficulties in proving those allegations at trial.[276] These evidentiary difficulties to a great extent arise out of the same substantive questions that affect the charging decision or the decision to bring a civil action.[277] In particular, while direct, factual evidence may be available to satisfy some of the elements of a criminal or civil claim under Rule 10b-5, circumstantial evidence typically constitutes all or substantially all of the evidence in satisfaction of the scienter element.[278] It would seem that, where the prosecution or a

---

268. *See supra* Part III.B.2.

269. *See supra* Part III.B.3.

270. *See supra* notes 181-182 and accompanying text.

271. *See supra* notes 58-61 and accompanying text. For example, it may be difficult for a plaintiff to prove that, but for Stewart's public statements regarding the sale of her ImClone shares, he would not have purchased MSLO securities.

272. *See supra* notes 62-64 and accompanying text. For example, it may be difficult for a plaintiff to prove that, but for Stewart's public statements regarding the sale of her ImClone shares, she would not have suffered a loss (or as large a loss) on the sale of her MSLO securities.

273. *See supra* note 74 and accompanying text.

274. *See supra* note 168 and accompanying text.

275. *See supra* notes 168-169 and accompanying text.

276. *See generally supra* Part III.B.

277. *See supra* notes 267-270 and accompanying text.

278. *See supra* note 50 and accompanying text.

plaintiff is relying exclusively or primarily on circumstantial evidence to satisfy an element of its claim, sufficiency of the evidence is much more likely to be an issue, making more probable a motion for acquittal or for a directed verdict. A Rule 29 motion challenging the sufficiency of evidence is difficult for a court to decide, especially in the context of circumstantial evidence, because of an increased likelihood of questions relating to whether inferences or speculation are necessary or reasonable in drawing conclusions from the established facts.[279] Moreover, in a case where the nexus between the defendant's conduct and the securities market or investors is weak, circumstantial evidence and permissible inferences based on that evidence may impact more than just the scienter element of the claim. In particular, proof of the "in connection with" requirement is at risk. Given these evidentiary difficulties and the higher burden of proof applicable to criminal actions under Rule 10b-5, it is particularly hard for a federal prosecutor to prove a case of this kind.[280]

Moreover, the standard-based decisional law source for the elements of a Rule 10b-5 claim renders those elements somewhat amorphous and allows the federal courts to expand or contract the common understanding of one or more elements as new cases arise.[281] Accordingly, when a new or rare type of Rule 10b-5 claim is brought, it is difficult for the government or plaintiffs to be certain that the facts adduced at trial are sufficient to satisfy the required elements. In addition, it is difficult for a defendant to know what evidence to present to refute the newfangled Rule 10b-5 claim brought against her. The ultimate determination of these issues will be based on multiple decisions by varied federal courts, including, perhaps, the Supreme Court.

In this complex and ambiguous enforcement environment, the unique nature of the claims against Stewart had specific implications on her motion for acquittal. For example, the *Stewart* court expressly contends with the uniqueness of the government's claim in address-

279. *Cf.* United States v. Ruiz, 105 F.3d 1492, 1499-1500 (1st Cir. 1997) (describing the relationship among Rule 29, circumstantial evidence, and inferences); United States v. Mackay, 33 F.3d 489, 494 (5th Cir. 1994) ("Although the government may prove the existence of a conspiracy through circumstantial evidence, it 'must do more than pile inference upon inference upon which to base a conspiracy charge.'" (quoting United States v. Sheikh, 654 F.2d 1057, 1062-63 (5th Cir. 1981)).

280. *See* Caillavet, *supra* note 158, at 1040-41; *see also supra* notes 76-78 and accompanying text.

281. *See supra* Part I.A.1-3 (describing the key elements of a Rule 10b-5 claim and the uncertainties associated with the interpretation of those elements); *see also supra* note 159 and accompanying text (referencing the expansiveness of legal theories under Rule 10b-5).

ing its request for an inference as to the scienter element based on the falsity of Stewart's public statements. The court finds that the prosecution is not entitled to that inference of scienter, expressly distinguishing this type of case from others under Rule 10b-5 in which an inference was permitted based on false public statements.

> In some securities fraud cases, the falsity of a defendant's statements may lend weight to an inference of intent to deceive. But in this case, the falsehoods lack a direct connection to the supposed purpose of the alleged deception. The falsehoods involve Stewart's personal trade in the securities of ImClone. Evidence of intent to defraud investors of a different company is not readily discernible from the content of the falsehoods.[282]

If the government, the SEC, or private plaintiffs bring additional Rule 10b-5 claims based on misstatements of personal information, the academy and the securities bar should expect further judicial clarification of the elements, contours, and evidentiary implications of Rule 10b-5 in this new context.

C. *Prosecutorial and Judicial Conduct in the Context of Rule 10b-5*

Although a number of noted scholars and other commentators already have written about the charging decisions and the court's judgment of acquittal in the *Stewart* case,[283] a few additional observations are warranted in light of the analyses included in this Article. Specifically, it is important to note a few key points about the interaction between prosecutorial and judicial discretion and the substantive aspects of Rule 10b-5. The Stewart prosecution sheds additional light on these subjects and reinforces existing scholarship. Each of these observations bears further thought and analysis in the context of a Rule 10b-5 charge against an insider based on misrepresentations of personal facts.

Academic attacks on prosecutorial discretion are common. In large part, this results from the fact that the exercise of prosecutorial discretion is regulated by standards that are so broad as to run the risk of being meaningless.[284] The potential for exploitation is apparent

---

282. United States v. Stewart, 305 F. Supp. 2d 368, 378 (S.D.N.Y. 2004).

283. *See supra* note 5 and accompanying text.

284. *See* Steven D. Clymer, *Unequal Justice: The Federalization of Criminal Law*, 70 S. CAL. L. REV. 643, 697-700 (1997) (noting that current guidelines do not "require federal prosecutors to have a rational basis for making" prosecutorial decisions); James Vorenberg, *Decent Restraint of Prosecutorial Power*, 94 HARV. L. REV. 1521, 1544 (1981) (finding federal policy guidelines to be "general, malleable, and unhelpful"). For an interesting, recent critique

and is a source of concern regardless of whether actual abuse occurs with any significant frequency.[285] In particular, the application of this wide-ranging discretion in the field by individual U.S. Attorneys in different offices in the context of broad criminal prohibitions that are substantially shaped by standards-based decisional law (as is the case for criminal prosecutions under Rule 10b-5), can have far-reaching effects on the substantive content of the law.[286] These potential effects are not an apparent factor in the charging decision and should be considered in a more formalized way in the prosecutorial decisionmaking process.

The exercise of judicial discretion may have similarly important substantive effects. The court chose to decide Stewart's Rule 29 motion before putting the case to the jury rather than waiting until after the jury returned a guilty verdict.[287] This is one of the relatively rare instances in which a federal trial judge in a criminal jury trial gets the opportunity to make significant law in a reported decision that is unappealable.[288] Notably, the acquittal opinion itself contributes to the decisional law relating to the scienter element of Rule 10b-5.[289] However, the court's failure to resolve latent issues relating to the materiality and "in connection with" elements under Rule 10b-5 leaves a substantive void that the court could have helped fill. Judicial discretion should be exercised very carefully and explained thoroughly in this environment.

The timing of the court's decision may have caused the court to restrict the scope of its opinion. If the court had waited until after a guilty verdict to decide Stewart's Rule 29 motion, the court's opinion would have been appealable.[290] It is possible (although this *is* specula-

---

of the *U.S. Attorneys' Manual*, see Mark Osler, *This Changes Everything: A Call for a Directive, Goal-Oriented Principle to Guide the Exercise of Discretion by Federal Prosecutors*, 39 VAL. U. L. REV. 625, 635-40 (2005).

285. For example, prosecutors, like other decisionmakers, are subject to cognitive biases that may impact their ability to exercise the broad discretion afforded them. *See* Alafair S. Burke, *Improving Prosecutorial Decision Making: Some Lessons of Cognitive Science*, 47 WM. & MARY L. REV. (forthcoming 2006) (suggesting that prosecutorial decisionmaking failures may be the result of cognitive biases).

286. *See supra* note 159 and accompanying text.

287. *See supra* note 200 and accompanying text.

288. *See supra* note 201 and accompanying text.

289. *See supra* notes 242-251 and accompanying text. Although (perhaps) distinguishable on its facts from many other Rule 10b-5 actions, the *Stewart* case is the only reported Rule 10b-5 decision located by this Author in which a corporate insider has been subject to legal proceedings for public disclosures regarding a personal transaction.

290. *See* Dawn M. Phillips, *When Rules Are More Important Than Justice*, 87 J. CRIM. L. & CRIMINOLOGY 1040, 1043 (1997) ("If a jury returns a guilty verdict, the government can appeal a trial court's order granting a motion for judgment of acquittal because a success-

tion) that the court would have written a more comprehensive opinion—one that addresses each element required to be proven by the government (or at least each element raised by Stewart in arguing the motion for acquittal)—if the court had ruled on the motion after a guilty verdict had been entered.[291] The mere possibility of appellate review may incentivize a higher quality of judicial decisionmaking, and actual appellate decisions should afford greater stability and certainty to the evolving decisional law under Rule 10b-5.[292] Accordingly, when a Rule 29 motion involves a complex and unsettled area or novel application of the law (as it did in the *Stewart* case), there are important reasons why a judge should exercise restraint and wait to rule on the motion until after the jury has reached a guilty verdict.

VI. CONCLUSION

"Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud."[293] Yet, the nature of securities fraud under section 10(b) and Rule 10b-5 continues to evolve to include new types of conduct and potential enforcement targets. The Martha Stewart Rule 10b-5 prosecution begins to explore the current outer limits of securities fraud under Rule 10b-5 in a post-Enron world. For key corporate executives—in particular, those who are strongly identified with the corporations they manage—the calculus as to the conduct and disclosure of their personal affairs now has changed.[294] They now should know that they may be subject to legal action based on a misrepresentation of (or a failure to disclose) personal facts. Those that

---

ful appeal by the government would not necessitate a retrial in violation of the Double Jeopardy Clause. Instead, the appeals court would remand the case for reinstatement of the jury verdict." (footnote omitted)).

291. Other facts may have influenced the court's decision on the substantive contents of its opinion. *See, e.g.*, Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 100-11 (2002) (describing three features of judicial decisionmaking in the securities class action context that explain the use of heuristics in that decisionmaking, many of which would be applicable in other federal securities litigation contexts); Donald C. Langevoort, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?*, 51 EMORY L.J. 309, 313-18 (2002) (supplementing the Bainbridge & Gulati analysis with further observations about decisionmaking in securities fraud cases).

292. *See* Sauber & Waldman, *supra* note 201, at 452-56 (making similar arguments in support of eliminating the power of trial judges to order pre-verdict judgments of acquittal).

293. Chiarella v. United States, 445 U.S. 222, 234-35 (1980).

294. *See* Oesterle, *supra* note 5, at 480 ("[T]he threat of the charge undoubtedly substantially increases the potential downside risk of any claim of innocence by a high profile CEO."). This is true regardless of whether any executive actually would be found guilty of, or liable for, any Rule 10b-5 violation based on the misstatement of, or omission to state, personal facts.

desire these actions to succeed may argue for more specific guidance on the interplay between this kind of misstatement and the various applicable elements of Rule 10b-5 claims.

However, if this is not what Congress, the SEC, or corporate America desires, it is now time to speak up and take action. Moderate action could include congressional lawmaking (or SEC rulemaking or interpretive guidance) on the meaning of the elements under Rule 10b-5 in cases involving misrepresentations of personal facts. Possible solutions lie in establishing rebuttable presumptions, shifting burdens of proof, and clarifying the substantive nature of inquiries under each element. Adding precision to the application of Rule 10b-5 in this context certainly would give key executives better guidance regarding disclosure of their personal affairs.

On the other hand, a more radical solution may be more appropriate. Perhaps *no* cause of action should exist based on an executive's misstatement of personal information; perhaps, investors should be made responsible for their own investment decisionmaking—at least to the extent of rational or normative behavior—when it is based on information of a noncorporate nature.[295] Adoption of this solution requires that lawmakers revisit the key policy underpinnings of the 1934 Act, the promotion of investor protection and market integrity. This inquiry may well lead to a conclusion that, in protecting investors who trade based on publicly disclosed personal information about key corporate executives, we are not promoting market integrity. Specifically, if Rule 10b-5 is interpreted in a manner that protects the (likely narrow) class of investors that trade on the basis of personal information about key corporate executives (rather than information about business fundamentals), investors and the public-at-large may lose confidence in our public markets for securities because regulatory and corporate resources are being squandered on protecting a fringe class of the overall investment community. Moreover, there is a risk that *desired* disclosures of personal information by corporate insiders will be stifled in an effort to protect investors that rely exclusively or heavily on insider disclosures of personal information in making their investment decisions (instead of merely taking the disclosed facts into consideration as part of the total mix of information available).

Rule 10b-5 is not a cure-all for market risk.[296] It should not be

---

295. *Cf. id.* at 480-81 (noting, in reference to the *Stewart* case, that "[p]rosecutors unwittingly were ignorant of a subtlety of securities law long understood by the courts in deciding Rule 10b-5 cases, that not all acts that affect stock price should be actionable").

296. William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 EMORY L.J. 843, 975 (2005) (asserting that, under Rule 10b-5, "wrongdoers . . . are

interpreted in a manner that protects investors against themselves or against risks that they voluntarily assume in purchasing or selling a security.[297] Consistent with its language and its judicially constructed purpose, Rule 10b-5 should protect investors and the market against conduct, including inaccurate or incomplete public disclosures of business-oriented and corporate-affecting information, that is calculated to manipulate the market for a corporation's securities or deceive investors. Accordingly, any solution to the problem of whether or how to treat alleged misrepresentations of personal information as violations of Rule 10b-5 should balance the significance of the disclosure of that type of information (in light of other publicly available information) against the possible reasons for, and timing and manner of, the release of the alleged misstatements. To achieve this objective, Congress, the SEC, or our federal courts must establish a clearer, more uniform meaning of the three core elements of a Rule 10b-5 cause of action in light of the foundational statutory goals of promoting investor protection and market integrity.

Do we want to punish the corporate executives that make voluntary disclosures of inaccurate or incomplete personal information? Do we want to reward investors that trade on the basis of those voluntary disclosures?[298] Would that punishment and reward system further the overall protection of investors? Would it promote confidence in the public markets for securities? Is it otherwise in the public interest? Time spent by Congress, the SEC, and the courts in reasoning through these important, but difficult, questions could serve as a catalyst for far-reaching legal change.

---

not insurers against market risk—or madness."); Bhavik R. Patel, Note, *Securities Regulation—Fraud Rule 10b-5 No Longer Scares the Judiciary, but May Scare Corporate Defendants: The United States Supreme Court Switches Directions.* Wharf (Holdings) Ltd. v. United International Holdings, Inc., *532 U.S. 588 (2001)*, 25 U. ARK. LITTLE ROCK L. REV. 191, 205 (2002) ("Abuses of Rule 10b-5 have caused severe consequences; for example, supporters of reform assert that individuals use Rule 10b-5 to hedge the risk of investment. Such abuse occurs when investors simply sue under Rule 10b-5 to recover from an unexpected loss." (footnotes omitted)).

297. *See, e.g.*, Caan v. Kane-Miller Corp., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,446, at 99,242 (S.D.N.Y. Feb. 5, 1976) ("[T]he securities laws are not to be used as an insurance policy for investors who choose voluntarily to disregard facts which would have been uncovered by any reasonable person in their position."). For example, investors who bought MSLO securities in June 2002 on the basis of Stewart's public statements about the reason for her ImClone stock sale assumed the risk that, even if that explanation were accurate and complete, a judge or jury could find that Stewart violated the law and impose penalties (including imprisonment) on her for that violation.

298. *See* Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 903 (1992) (raising a similar question: "if investors *as a group* unwisely overreact to a bit of misinformation, should the defendant therefore be held responsible to all traders?").