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Martha Stewart Faces Wider Probe Over Her Sale of Shares of ImClone

Investigators Search for Obstruction, False Statements; Merrill Assistant Reverses His Account of Transaction

By Charles Gasparino and Jerry Markon Staff Reporters of The Wall Street Journal

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Federal prosecutors have widened their probe of Martha Stewart beyond insider trading to include possible obstruction of justice and making false statements, a person with knowledge of the case said. At issue is whether the lifestyle guru misled prosecutors in explaining why she sold shares of ImClone Systems Inc. late last year immediately before damaging news about the company was made public.

Adding pressure on Ms. Stewart, the assistant to her Merrill Lynch & Co. stockbroker has reversed his initial account of the transaction, people familiar with the matter said. The sales assistant, Douglas Faneuil, conceded that he initially misled the brokerage firm's lawyers and the Securities and Exchange Commission when he backed up an account by Ms. Stewart and her Merrill broker, Peter Bacanovic, as to the reason behind Ms. Stewart's stock sale, these people said.

Federal prosecutors, market regulators and Congress are examining the suspicious trading of ImClone stock by Ms. Stewart and others, including former chief executive Samuel Waksal and members of his family, in the days leading up to ImClone's announcement on Dec. 28 that the Food and Drug Administration had refused to consider an application for its cancer-fighting drug, Erbitux.

Mr. Waksal was arrested June 12 and charged with insider trading for allegedly tipping off family members and trying to sell his shares before the FDA news was made public. But federal prosecutors are now boring in on Ms. Stewart, a close friend of Mr. Waksal, and Mr. Bacanovic, who also was Mr. Waksal's broker, so intently that the broader investigation of Mr. Waksal and his family members who sold stock is on hold.

Ms. Stewart made a scheduled appearance Tuesday on CBS's "The Early Show," where host Jane Clayson asked her about the stock sale while she was mixing a salad. Ms. Stewart responded that she wanted "to focus on my salad," and then added that she "will be exonerated of any ridiculousness."



Samuel Waksal

Mr. Bacanovic has told Merrill officials and the SEC that he had a prearranged agreement with Ms. Stewart to sell the stock, people familiar with the matter said. Ms. Stewart sold nearly 4,000 shares of the biotechnology company's stock on Dec. 27, one day before the announcement on Erbitux. Ms. Stewart, a friend of Mr. Waksal, has cited such an agreement in her public statements to deny the suggestion that she illegally traded on inside information.

But Mr. Faneuil, a 26-year-old sales clerk who has worked for the firm for about a year, now has told Merrill lawyers that he was unaware of any such arrangement and that he concocted his initial account after being pressured by Mr. Bacanovic, these people said. Merrill lawyers have conveyed the new information to prosecutors. Merrill officials say they believe Mr. Faneuil would have known about the arrangement if one had existed.

Mr. Faneuil's turnabout could prove to be significant to the unfolding investigation because it casts doubt on the existence of a pre-arranged selling agreement. The U.S. Attorney's office in Manhattan plans to interview Mr. Faneuil again on the matter as soon as Wednesday, people familiar with the matter said.

On Friday, Merrill placed Messrs. Bacanovic and Faneuil on paid administrative leave, citing "factual issues regarding a client transaction" as the reason for the move.

Ms. Stewart's lawyer and spokeswoman couldn't immediately be reached to comment on the widening probe.

Mr. Faneuil also couldn't be reached for comment. Jamie Moss, a spokeswoman for Mr. Faneuil's attorney, Marc Powers, declined to comment about Mr. Faneuil's discussions with Merrill and SEC investigators. Mr. Powers didn't return calls. Richard M. Strassberg, a lawyer for Mr. Bacanovic, declined to comment, nor did a spokesman for Merrill.

Little is known about Mr. Faneuil. According to his employment data listed on National Association of Securities Dealers records, Mr. Faneuil spent some time working at D.E Shaw & Co., an investment firm, from 1997 through April of last year. Other of his past employers listed on the documents are Vassar College, Bennington College and Bill's House of Pizza, Boston, N.Y., where he worked from 1991 through 1993.

On Tuesday, shares in Ms. Stewart's home-decorating company, Martha Stewart Living Omnimedia Inc., rose \$1.05, or 8.4%, to \$13.60 in 4 p.m. composite trading on the New York Stock Exchange. But shares of the New York-based company have declined nearly 20% since Ms. Stewart's stock sale in December.

The issue of whether a pre-arranged sale agreement existed has been controversial from the start. Ms. Stewart has said publicly in recent days-- and told prosecutors when they interviewed her in April -- that she struck a verbal agreement in late November that would trigger the sale of ImClone stock at below \$60. Mr. Bacanovic said it was placed in December, and has said he has notes to back it up. But verbal

stop-loss agreements are uncommon on Wall Street to avoid confusion; most brokers officially log such arrangements into the firm's computer system to keep a detailed record of the trade.

Many of the facts involving the trading of Ms. Stewart's shares remain unclear. Among the issues still murky: What exactly did Ms. Stewart know about the FDA action before she sold her shares. Mr. Bacanovic has told Merrill lawyers that one reason he sold shares for her was because there were negative rumors in the market about the stock, rather than because of any direct knowledge of the FDA action.

If Ms. Stewart merely sold shares because of market rumors, she wouldn't have violated federal insider trading laws. Indeed, a key element to any insider-trading charge is intent: Ms. Stewart must have known that they were trading on material non-public information.

A potential and more problematic issue could be obstruction of justice, legal experts said. This would have occurred if any of the individuals involved in the matter concocted a story, for instance, about a stop-loss arrangement, when none existed, thus misleading federal investigators in the process.

Unlike insider trading, "an obstruction-of-justice case is usually fairly straightforward; in insider trading, you have to prove intent, so the cases can be more difficult," said Michael Lazerwitz, a former federal prosecutor and now a partner at Cleary Gottlieb Steen & Hamilton in Washington, D.C.

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