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03 CV 4070

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

MARTHA STEWART and PETER BACANOVIC,

Defendants.

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03 Civ.

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission"), for its Complaint against defendants Martha Stewart ("Stewart") and Peter Bacanovic ("Bacanovic") (collectively the "Defendants"), alleges as follows:

1. The Commission charges Stewart and Bacanovic with committing securities fraud by engaging in illegal insider trading. Stewart sold stock in a biopharmaceutical company, ImClone Systems, Inc. ("ImClone"), on December 27, 2001 after receiving material, nonpublic information from Bacanovic, who was Stewart's broker at Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"). Stewart's unlawful trade came as ImClone and the market anxiously awaited an imminent decision from the Food and Drug Administration ("FDA") on one of ImClone's key products, a cancer drug called "Erbitux." On December 27,

2001, Bacanovic learned that two of his other clients – ImClone CEO Samuel Waksal ("Waksal") and his daughter Aliza Waksal – had placed orders to sell all of the ImClone stock they held at Merrill Lynch. In violation of Merrill Lynch policies governing the confidentiality of client transactions, Bacanovic instructed his assistant, Douglas Faneuil ("Faneuil"), to tell Stewart about the Waksals' sell orders, which were not public information. Information that the Waksals' were selling would have been important to the reasonable investor because, among other things, those sell orders signaled insider pessimism about the anticipated FDA decision, the prospects for Erbitux, and the future of ImClone.

2. Promptly upon learning that the Waksals were selling or attempting to sell all of their ImClone stock at Merrill Lynch, Stewart placed an order to sell all 3,928 shares of her ImClone stock. The following evening, December 28, ImClone announced disappointing news about Erbitux: that the FDA had issued a Refusal to File ("RTF") letter to ImClone stating that the ImClone's application for Erbitux was deficient and would not be filed for review. This meant a major setback for ImClone's efforts to bring Erbitux to market. By the end of the next trading day, December 31, the price per share of ImClone stock had dropped 16 percent. By selling when she did, Stewart avoided losses of $45,673.

3. By the conduct alleged herein, the Defendants, directly or indirectly, have engaged, and, unless enjoined, and restrained, will again engage, in transactions, acts, practices or courses of business that constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §77q(a), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, thereunder.

JURISDICTION AND VENUE

4. The Commission brings this action pursuant to its authority under Section 20(b) of the Securities Act, 15 U.S.C. § 77t(b), and Section 21(d) of the Exchange Act, 15 U.S.C. § 78u(d), to enjoin the Defendants from engaging in the transactions, acts, practices, and courses of business alleged in this Complaint, for disgorgement of the losses avoided and prejudgment interest thereon, and for civil penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d) of the Exchange Act, 15 U.S.C. § 78u(d)(3). The Commission also brings this action pursuant to Section 21A of the Exchange Act, 15 U.S.C. § 78u-1, for civil penalties against the Defendants under the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"). In addition, the Commission seeks an order barring Stewart from acting as a director of, and limiting her activities as an officer of, any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 781, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d). The Commission also seeks such other relief as the Court may deem appropriate.

5. The Defendants, directly or indirectly, singly or in concert, made use of the means or instruments of transportation or communication in, or the means or instrumentalities of, interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged herein. Certain of the alleged transactions, acts, practices, and courses of business occurred in the Southern District of New York, including, but not limited to, Bacanovic's tipping, through Faneuil, of material nonpublic information to Stewart and Stewart's sale of ImClone stock. Accordingly, this Court has jurisdiction over this action, and venue is proper in this district, pursuant to

Sections 20(b) and 22(a) of the Securities Act, 15 U.S.C. §§ 77t(b), 77v(a), and Sections 21(d), 21A, and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d), 78u-1, and 78aa.

RELEVANT INDIVIDUALS AND ENTITIES

A. Defendants

6. **Stewart**, 61, is a media personality and authority on homemaking, cooking, decor, and other activities related to the home. Earlier in Stewart's career, in the late 1960's and early 1970's, Stewart was a registered representative for the broker-dealer, Pearlberg, Monness, Williams & Day. She is now the CEO and Chairman of Martha Stewart Living Omnimedia, Inc. ("MSO"), which, according to its most recent 10-K filed on March 31, 2003, is a media and retail company that focuses on "the domestic arts, providing consumers with the how-to ideas, information, merchandise and other resources they need to raise the quality of living in and around their homes." From June 2002 to October 2002, Stewart was a member of the Board of Directors of the New York Stock Exchange, Inc., and she is currently a member of the Board of Directors of Revlon, Inc. Stewart owns approximately 61% of the equity and 94% of the voting power of MSO, through her ownership of Class A and Class B shares of MSO. In an affidavit dated August 23, 2002, Stewart invoked her Fifth Amendment privilege against self-incrimination in response to a Commission investigative subpoena to testify about the events alleged in this Complaint.

7. **Bacanovic**, 41, was, as of December 2001, a registered representative employed by Merrill Lynch. He has received Series 7, 63 and 65 securities licenses. His clients included Stewart, Waksal, and Waksal's daughter, Aliza. In June 2002, Merrill Lynch suspended Bacanovic indefinitely with pay. On October 2, 2002, Merrill Lynch terminated Bacanovic's

employment. On February 13, 2002, Bacanovic gave sworn testimony before the Commission staff in the investigation preceding this Complaint. On September 18, 2002, in response to a Commission investigative subpoena to testify about the events alleged in this Complaint, Bacanovic invoked his Fifth Amendment privilege against self-incrimination.

B. Others

8. **Faneuil**, 27, was, as of December 2001, a registered representative employed by Merrill Lynch and worked as Bacanovic's assistant. On October 2, 2002, Faneuil pleaded guilty to a federal misdemeanor for accepting gifts from Bacanovic in exchange for failing to inform the Commission and the FBI of Stewart's and Bacanovic's illegal conduct relating to the matters alleged in this Complaint. Also on October 2, 2002, Merrill Lynch terminated Faneuil's employment.

9. **ImClone** is a Delaware corporation headquartered in New York, New York. During 2001, ImClone's securities were registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on The Nasdaq Stock Market. ImClone is a biopharmaceutical company currently developing several cancer treatments, including its lead product, Erbitux.

STEWART'S AND BACANOVIC'S ILLEGAL CONDUCT

Background

10. Stewart became friendly with Waksal in the early 1990s. Waksal is the co-founder of ImClone and, until May 22, 2002, was ImClone's CEO. As of December 27, 2001, Stewart owned 3,928 shares of ImClone stock. In addition, as of December 27, 2001, Stewart,

Waksal, and Waksal's daughter, Aliza Waksal, all had brokerage accounts with Bacanovic at Merrill Lynch, and Stewart knew that Waksal had an account with Bacanovic.

11. Stewart and Bacanovic have known each other since the mid-1980s. Stewart had been Bacanovic's client since the mid-1990s and was one of his most important clients. Bacanovic handled Stewart's pension, her personal accounts, and MSO's 401(k) plan. Bacanovic also administered the Friends and Family program for the MSO IPO and the Employee Stock Option Program for MSO. Many MSO employees used Bacanovic as their financial adviser.

12. Bacanovic has known Waksal since 1989, when a friend of Waksal introduced them. On Waksal's invitation, Bacanovic joined ImClone and worked for the company's marketing department from June 1990 to July 1992. Waksal opened an account with Bacanovic at Merrill Lynch in 1994.

13. Since 1992, Waksal and his brother, Harlan Waksal, had devoted much of ImClone's resources to developing a promising cancer drug, Erbitux, with the objective of obtaining FDA approval and bringing Erbitux to market. On October 31, 2001, ImClone submitted to the FDA the final substantial portion of its rolling application for approval, called a "Biologics License Application" or "BLA." ImClone's October 31 submission of its BLA gave the FDA 60 days – until Monday, December 31 – to decide whether to accept the application for filing. By the end of December 2001, the FDA had three options: it could (1) accept ImClone's BLA for filing; (2) accept the BLA for filing, but simultaneously issue a disciplinary review letter notifying ImClone that the BLA still had serious deficiencies that it would need to correct before the BLA could be approved; or (3) refuse to file the BLA by issuing an RTF letter. The

issuance of an RTF letter is a disappointing development for an applicant because it means that the applicant must file a new BLA to begin the process again. As of December 27, 2001, Stewart knew that ImClone was developing Erbitux and that it was under FDA review.

14. In late 2001, the market and ImClone investors anxiously awaited the FDA decision on ImClone's Erbitux application. On December 26, 2001, before any formal action by the FDA, Waksal privately learned that the FDA had decided to refuse to file ImClone's BLA. On December 28, the FDA sent ImClone an RTF letter. After the market closed on December 28, ImClone issued a press release, which disclosed that the FDA had issued an RTF letter. By the close of the next trading day, Monday, December 31, the price of ImClone stock dropped 16% to $46 a share.

15. Early in the morning on December 27, 2001, the day before ImClone publicly disclosed that it received an RTF letter from the FDA, Aliza Waksal called Faneuil at Merrill Lynch to place an order to sell all of her ImClone shares. Sam Waksal's accountant also called Faneuil to order the sale of all of the ImClone shares held in Waksal's Merrill Lynch account. Faneuil spent his morning talking to Bacanovic by phone (Bacanovic was vacationing in Florida) and to other Merrill Lynch supervisors in New York about whether Waksal could sell his ImClone shares, either directly or through his daughter's account. He also told Bacanovic about Aliza Waksal's sale of ImClone stock.

Bacanovic's Duty to Keep Client Transactions Confidential

16. As of December 27, 2001, the Waksals' efforts and instructions to sell their ImClone stock were not public and Merrill Lynch policies specifically required employees to keep information about those transactions confidential. Indeed, Merrill Lynch had in place at

least four policies that prohibited employees, such as Bacanovic and Faneuil, from disclosing client transactions to others or effecting trades on information about client securities transactions. These policies included Merrill Lynch's (1) insider trading policy, (2) prohibition on disclosing business and client information, (3) policy on protecting the confidentiality of client information, and (4) prohibition on disclosing or using client orders for another client's benefit.

a. The insider trading policy stated, in pertinent part:

> U.S. Federal and State securities laws and laws of certain other countries make it unlawful for anyone in possession of non-public material information to take advantage of such information in connection with purchasing or selling securities or recommending to others the purchase of [sic] sale of securities. Such information must not be disclosed to others who may, thereafter, take advantage of it in purchasing or selling securities.
>
> Information is material if a reasonable person would want to consider it in determining whether to engage in a securities transaction or if it could reasonably be expected to affect the market price of a security if it becomes generally known. Information should be considered non-public if it has not been disclosed in the news media, research reports, corporate public filings or reports, or in some other similar public manner. Non-public information should generally be regarded as material unless it is clearly unimportant to investors.

b. The policy limiting disclosure of Merrill Lynch's business and client information stated, in pertinent part:

> You may not discuss the business affairs of any client with anyone, including other employees except on a need-to-know basis. Information or records concerning the business of the Firm and/or its clients may not be released except to persons legally entitled to receive them.

c. The policy protecting the confidentiality of client information stated, in pertinent part:

> Merrill Lynch protects the confidentiality and security of **client information**. Employees must understand the need for the careful handling of this **information**.
>
> Merrill Lynch's **client information** privacy policy provides that --
> ...
>
> - Employees may not discuss the business affairs of any **client** with any other employee, except on a strict need-to-know basis.
> - We do not release **client information**, except upon a **client's** authorization or when permitted or required by law.

d. The policy prohibiting disclosure of client orders stated, in pertinent part:

> Information on client orders may not be disclosed to any other person for other than bona fide business purposes, or used as the basis of any solicitation.
>
> You should not "piggyback;" that is, enter transactions after a client's trades to take advantage of perceived expertise or knowledge on the part of the client. If the client's successful trading pattern arose from an improper element such as inside information, you (and the Firm) could be subject to a regulatory or criminal investigation or proceeding.

17. During December 2001 and all other times relevant herein, Bacanovic was aware of the Merrill Lynch policies alleged in paragraph 16, above. For example, On August 14, 2001, Bacanovic signed an acknowledgement that he had received and read those Merrill Lynch policies. In addition, in April 2001, Merrill Lynch sent its customers, including Stewart, Merrill Lynch's "Privacy Pledge" which explained, among other things, that "[w]e restrict access to your personal financial information to personnel who need that information to provide you with our products and services."

Bacanovic Tips Stewart

18. On the morning of December 27, 2001, in response to hearing from Faneuil that Waksal and his daughter had placed orders to sell all of their ImClone stock at Merrill Lynch, Bacanovic told Faneuil to call Stewart with Bacanovic on the line. They did not reach Stewart, but Bacanovic left a message with Stewart's assistant, that "Peter Bacanovic thinks ImClone is going to start trading downward." Later that morning, Bacanovic once again spoke with Faneuil and, in violation of the Merrill Lynch policies set forth in paragraph 16 above, instructed Faneuil to tell Stewart that Waksal and his daughter were selling or attempting to sell their ImClone stock held in their Merrill Lynch accounts.

19. When Bacanovic left his telephone message for Stewart, as set forth in paragraph 18 above, Stewart was on an airplane to Mexico for vacation. During the early afternoon of December 27, the airplane landed to refuel at an airport in San Antonio, Texas and Stewart checked her messages. After receiving Bacanovic's message from her assistant, Stewart had her assistant connect her to Merrill Lynch. Faneuil answered and, pursuant to Bacanovic's instructions, told Stewart that Waksal and his daughter were selling or attempting to sell all of their ImClone shares at Merrill Lynch and that Bacanovic believed that Stewart might wish to act on that information. Stewart asked Faneuil for the current market price of ImClone shares and was given a quote of approximately $58 per share. Stewart then instructed Faneuil to sell all of her ImClone shares. Faneuil immediately placed an order to sell all 3,928 of Stewart's ImClone shares and that order was executed at an average price of $58.43. Stewart then immediately called Waksal, and left the following message: "Martha Stewart something is going on with

ImClone and she wants to know what...." By selling one day before ImClone announced that the FDA had issued an RTF letter, Stewart avoided losses of $45,673.

20. The information that Waksal and his daughter were selling, or attempting to sell, all their ImClone stock at Merrill Lynch was material. For example, against the total mix of information publicly available about ImClone during December 2001, knowledge of efforts by ImClone's CEO and his daughter to sell their ImClone stock would have signaled to the reasonable investor insider pessimism about the FDA's anticipated decision, the prospects for Erbitux, and the future of ImClone. The information about the Waksals' efforts to sell their ImClone stock is the type of information that ordinarily derives its utility from securities trading. For example, the Merrill Lynch policies set forth in paragraph 16 above, and the media – including *The Wall Street Journal's* periodic column "Insider Trading Spotlight" and investor newsletters and websites – recognize that investors look to information about trading by insiders at a company to inform their investment decisions about a company.

21. Bacanovic knew or acted in reckless disregard of the fact that information about the Waksals' efforts to sell their ImClone stock was nonpublic and that, by communicating that information to Stewart, Bacanovic was breaching his duty of confidentiality to Merrill Lynch. Bacanovic benefited from his illegal tip by, for example, improving his relationship with Stewart, an important client of Bacanovic. Stewart knew or acted in reckless disregard of the fact that information about the Waksals' efforts to sell their ImClone stock was nonpublic and that Bacanovic had communicated that information to her in breach of Bacanovic's duty of confidentiality to Merrill Lynch.

Stewart's and Bacanovic's Attempts to Conceal their Illegal Conduct

22. On multiple occasions, the Defendants lied to the Commission's staff, the United States Attorney's Office for the Southern District of New York ("USAO"), and the FBI (collectively, the "Government") about the events of December 27, 2001 and the facts surrounding Stewart's sale of ImClone stock. The Defendants did so because they knew that their conduct on December 27, 2001 was unlawful and sought to conceal the true facts.

23. The Defendants fabricated an alibi for Stewart's trade and misrepresented facts concerning Stewart's trade. In interviews on February 4 and April 10, 2002 with the Government, Stewart falsely stated, among other things, that: (1) she sold her ImClone stock because she and Bacanovic had decided in November or December that she would sell if ImClone's stock price fell below $60 per share; (2) she placed her order directly with Bacanovic, not Faneuil; (3) she did not know whether Waksal was Bacanovic's client; and (4) she had no recollection of being told that any of the Waksals were selling their ImClone stock.

24. Bacanovic, in sworn testimony before the Commission staff, told falsehoods similar to those alleged in paragraph 23, above. Bacanovic testified that, on December 20, 2001, he and Stewart had a telephonic meeting to review her entire stock portfolio and make decisions about which of the dozen or so stocks she held in her portfolio they could sell for a loss. He further testified that in the course of this review, Bacanovic suggested that Stewart sell all of her ImClone shares. According to Bacanovic, Stewart resisted the idea at first, telling Bacanovic that Erbitux was a promising drug that was so close to FDA approval. Bacanovic testified that on that date, December 20, 2001, when ImClone was trading at between $61 and $64 per share, Bacanovic was able to convince Stewart to sell ImClone if it fell below $60 per share.

25. In fact, Bacanovic and Stewart never entered into an agreement to sell Stewart's ImClone stock if the price fell below $60. Rather, Stewart and Bacanovic fabricated this story some time after December 27, 2001, when Merrill Lynch and the Commission staff began to question Bacanovic and Faneuil about the trade. Moreover, as of December 27, 2001, Stewart knew that Waksal had a brokerage account with Bacanovic. Stewart lied when she stated she had no recollection of Bacanovic telling her that any of the Waksals were selling their ImClone shares, and Bacanovic lied when he stated that he did not tell Stewart that Waksal was selling his ImClone shares. In addition, Bacanovic compensated Faneuil, and offered Faneuil additional vacation and free airline tickets, for not informing the Commission staff of the true facts surrounding Stewart's sale. In June 2002, Stewart repeated elements of her false alibi in public statements as part of her continuing effort to conceal the truth.

26. After the investigation into Stewart's ImClone trade commenced, Stewart tampered with and altered an important piece of evidence. On or about January 30, 2002, Stewart, after completing a phone call with her attorney just days before she was scheduled to meet with the USAO, FBI and Commission staff, altered the electronic text of the message left for her by Bacanovic on the morning of December 27, 2001. Stewart changed the message from its original text that "Peter Bacanovic thinks ImClone is going to start trading downward," to "Peter Bacanovic re: ImClone." Shortly after she altered the message, Stewart instructed her assistant to return the message to its original form.

CLAIM FOR RELIEF

The Defendants Violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

27. The Commission realleges and incorporates by reference the allegations contained in paragraphs 1 through 26, above.

28. The Defendants, directly or indirectly, singly or in concert, by the use of the means or instruments of transportation or communication in, or the means or instrumentalities of, interstate commerce, or by use of the mails, or of any facility of any national securities exchange, in the offer or sale, and in connection with the purchase or sale, of ImClone securities: (a) employed devices, schemes, or artifices to defraud; (b) obtained money or property by means of, or otherwise made, untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) engaged in transactions, acts, practices and courses of business which operated or would have operated as a fraud or deceit upon purchasers of ImClone securities and upon other persons, as more fully described in paragraphs 1 through 26.

29. On December 27, 2001, Bacanovic, in breach of a fiduciary duty, or other duty arising out of a relationship of trust and confidentiality that he owed to Merrill Lynch, conveyed to Stewart, through Faneuil, that the Waksals were selling or attempting to sell all of their ImClone stock at Merrill Lynch.

30. While in possession of the information that the Waksals were selling or attempting to sell their ImClone stock, Stewart sold 3,928 shares of ImClone stock on December 27, 2001.

31. The information that Stewart possessed on December 27, 2001, that the Waksals were selling or attempting to sell their ImClone stock, was material and nonpublic.

32. When Stewart sold ImClone securities on December 27, 2001, Stewart knew or acted in reckless disregard of the fact that: (1) she possessed confidential information that the Waskals were selling or attempting to sell their ImClone stock; and (2) Bacanovic's conveyance of this material and confidential information to her constituted a breach of fiduciary duty, or other duty arising out of a relationship of trust and confidence, that Bacanovic owed to Merrill Lynch.

33. By reason of the foregoing, the Defendants, singly or in concert, directly or indirectly, violated, and unless enjoined will again violate, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

RELIEF SOUGHT

WHEREFORE, Plaintiff respectfully requests a Final Judgment:

A. Permanently enjoining the Defendants, their agents, servants, employees, and attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, and each of them, from future violations of Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5;

B. Ordering the Defendants to disgorge, jointly and severally, the losses avoided by Stewart's sale of ImClone securities and to pay prejudgment interest thereon;

C. Ordering the Defendants to pay civil money penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Sections 21(d) and 21A of the Exchange Act, 15 U.S.C. § 78u(d)(3) and § 78u-1;

D. Ordering that Stewart be barred from acting as a director of, and limiting her activities as an officer of, any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 781, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d); and

E. Granting such other relief as the Court shall deem just and proper.

Dated: New York, New York
June 4, 2003

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