

## White-Collar Crime

## Expert Analysis

# Insider Trading Among Family Members and the Limits of ‘Newman’

In the closely followed case of *United States v. Stewart*, the U.S. Attorney’s Office for the Southern District brought its first insider trading case to trial since the Second Circuit’s landmark decision in *United States v. Newman*, which increased the burden on prosecutors in tipper/tippee insider trading cases. *Newman* held that the government must prove that a tipper received a “personal benefit” by disclosing confidential information to a tippee, that the benefit cannot be established by the mere fact that the tipper and tippee are friends, and that the tippee must know of the benefit to the tipper.<sup>1</sup> These requirements come into play most strongly when the government prosecutes tippees who are one or more steps removed from the original source of the inside information because such “remote tippees” may know little or nothing about the original tipper, including why the information was disclosed and whether a personal benefit was involved.

The Supreme Court has granted review of a Ninth Circuit insider trading

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case involving a remote tippee, suggesting that the court will clarify *Newman*’s personal benefit standard. While we await that decision, the *Stewart* case is an important reminder that *Newman* has not changed all that much

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in a significant category of insider trading cases: tipper/tippee cases involving family members. In this article, we discuss the *Stewart* case and suggest how the government was able to secure a conviction against the tipper, a son who tipped his father, even though the

son received no meaningful financial benefit in return.

### ‘United States v. Stewart’

Sean Stewart was an investment banker at major financial institutions where he worked on health-care acquisitions.<sup>2</sup> The government alleged that Stewart tipped his father, Robert Stewart, about the acquisition of health-care companies. Robert traded based on his son’s information and tipped a friend and business associate, Richard Cunniffe, who also traded and shared the proceeds with Robert. Robert and Cunniffe made approximately \$1.2 million by trading based on impending mergers they learned about from Stewart. Robert and Cunniffe pleaded guilty to insider trading, and Cunniffe testified as a cooperating witness at Stewart’s trial.

At trial, Stewart admitted that he discussed material, non-public information about his work with Robert and other family members. But Stewart testified that he did not intend or expect his father, or anybody else, to trade on the confidential information he shared with them. Stewart argued that his father “betrayed” and “used” him by trading based on their

conversations, and tipping Cunniffe.<sup>3</sup> In short, Stewart's defense was that he did not have the requisite fraudulent intent because he did not tip Robert with the "understanding that the information would be used for securities trading purposes."<sup>4</sup> Consistent with that defense, when Robert pleaded guilty, he did not admit that Stewart knew Robert would be trading on inside information.

### Tenuous Personal Benefit

The government argued that Stewart received a tangible, pecuniary benefit from tipping his father, but the government's evidence on that point was thin. The government argued that, during the four years in which Stewart disclosed confidential information that was in turn used by Robert and Cunniffe, Robert gave Stewart two pecuniary benefits: (1) Robert paid for the photographer at Stewart's wedding, which cost roughly \$10,000; and (2) Robert separately gave Stewart \$15,000.

However, Stewart presented significant evidence that Robert did not make these payments to him in exchange for inside information. Stewart's parents also paid a \$7,000 photographer's bill for the wedding of Stewart's brother, which took place one month after Stewart's wedding, underscoring that it is hardly unusual for a parent to pay for a child's wedding expenses.<sup>5</sup> Further, the \$15,000 payment to Stewart was a partial repayment of \$35,000 that Stewart had given to Robert several weeks earlier and therefore was not a net pecuniary gain.<sup>6</sup>

### Evidence of Fraudulent Intent

The government presented more substantial evidence that Stewart knew that

his father was trading based on the confidential information they discussed. After Cunniffe began cooperating with the government, he secretly recorded conversations with Robert. Robert told Cunniffe that his son, Stewart, had scolded him for not taking advantage of a tip. Robert quoted Stewart as saying, "I can't believe I handed you this on a silver platter and you didn't invest in it." Stewart could not cross-examine Robert about the statement because Robert refused to testify based on his right against self-incrimination.

In addition, the government presented evidence that Stewart had lied to compliance officials at one of his employers, JPMorgan. After a public announcement of an event that significantly affects a public company's trading volume or stock price, FINRA often sends inquiry letters to entities connected to the transaction in an effort to identify those trading before the announcement. In July 2011, after Robert had purchased the stock of a company shortly before it was acquired, FINRA sent JPMorgan a list of individuals and entities that had traded in the acquired company, and asked that employees privy to the events leading up to the acquisition, including Stewart, identify any familiar names. The list included Robert, but Stewart did not identify him. When FINRA asked JPMorgan to confirm that Stewart did not recognize his father, Stewart identified his father but denied that he had discussed the acquired company with him. Stewart testified at trial that he lied to protect his career and his father.<sup>7</sup>

### 'Newman' and Family

Although *Newman* made it more difficult for the government to prove that

a tipper got a personal benefit, *Newman* was concerned chiefly with the issue of tips between casual friends or acquaintances. The decision did not address tips among close family members like Stewart and Robert. *Newman* held that the government cannot "prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature." Further, to the extent the government attempts to prove that the tipper obtained a personal benefit based on the "personal relationship between the tipper and tippee," *Newman* requires the relationship to be "meaningfully close" such that it "generates an exchange that is objective, consequential, and presents at least a potential gain of a pecuniary or similarly valuable nature."

Close family relationships between tipplers and tippees, like the relationship between a father and son, can readily satisfy this standard. Indeed, in *United States v. Salman*, the Ninth Circuit's insider trading decision that is currently before the Supreme Court, the Ninth Circuit questioned whether *Newman* can be "read to go so far" as requiring the exchange of a pecuniary benefit among tipper-tippee family members, since *Newman* itself recognized that a personal benefit "obtain[s] from simply making a gift of confidential information to a trading relative."<sup>8</sup>

The Ninth Circuit explained that, if the law were otherwise, "a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return." As a Rhode Island district court noted

earlier this year, *Newman* “does not foreclose the possibility that in some cases—particularly close familial relationships—the fact that the tip was given and traded on is, on its own, enough for an inference of the intention to benefit.”<sup>9</sup>

### Personal Benefit in ‘Stewart’

In the *Stewart* case, Southern District Judge Laura Taylor Swain similarly recognized that a close family relationship can satisfy *Newman*’s personal benefit standard in the absence of an exchange of monetary benefits. *Stewart* moved to dismiss the indictment on the ground that *Newman* rendered the personal benefit standard too vague to support a criminal prosecution. Whatever merit this argument might have in context of tips between loose acquaintances, Judge Swain held that *Stewart*’s alleged conduct satisfied “even the *Newman* formulation of the personal benefit requirement” because “*Stewart*’s family relationship with his father and the alleged receipt of pecuniary benefits can support inferences of exchange for personal benefit and at least a potential gain of a pecuniary or similarly valuable nature.”<sup>10</sup>

More significantly, Judge Swain’s jury instruction, the first post-*Newman* criminal insider trading instruction in the Southern District, framed *Newman*’s personal benefit standard in a manner that permitted the jury to find the requisite benefit based on a father-son relationship. The relevant portion of the charge stated, as follows:

In order to establish the fourth factor—personal benefit—the Government must prove beyond a reasonable doubt that Mr. *Stewart* anticipated receiving a personal

benefit in return for providing material non-public information to his father. Personal benefit is broadly defined to include pecuniary gain, as well as the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.... Although the receipt of personal benefit may be inferred from the personal relationship between Mr. *Stewart* and his father, you may only draw this inference if you find that

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there was an exchange between them that was objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.<sup>11</sup>

Because the jury was instructed that it could infer a personal benefit from a gift of confidential information to a relative, or, more precisely, “from the personal relationship between Mr. *Stewart* and his father” if the exchange “represents at least a potential gain of a pecuniary or similarly valuable nature,” the government was able to secure a conviction despite very limited evidence that *Stewart* had received

a specific monetary benefit from his father.

### Conclusion

*Newman* has generated uncertainty as to precisely what constitutes “personal benefit” in various kinds of relationships among tippers and tippees. But, as reflected in the jury instruction in *Stewart*, *Newman* does not do away with the common sense notion that family members typically receive a benefit when they help each other. In the end, the family drama that made the *Stewart* case so captivating also helped the government prove its case.



1. *United States v. Newman*, 773 F.3d 438, 442 (2d Cir. 2014).

2. Complaint, *United States v. Sean Stewart and Robert Stewart*, 15-MAG-1634 (S.D.N.Y.).

3. Peter J. Henning, “An Insider Trading Case That Pits Father Against Son,” *The New York Times* (Aug. 23, 2016); Stewart Bishop, “Ex-JPMorgan Banker Denies Insider Trading Claims at Trial,” *Law 360* (Aug. 4, 2016).

4. *United States v. Gansman*, 657 F.3d 85, 92 (2d Cir. 2011).

5. Bob Van Voris, “*Stewart* Tells Insider-Trading Jury He Lied to Protect Dad,” *Bloomberg* (Aug. 9, 2016).

6. *United States v. Stewart*, 15-CR-00287 (S.D.N.Y.), Dkt. No. 52 at 5-6.

7. Bob Van Voris, “*Stewart* Tells Insider-Trading Jury He Lied to Protect Dad,” *Bloomberg* (Aug. 9, 2016).

8. *United States v. Salman*, 792 F.3d 1087, 1093 (9th Cir. 2015).

9. *Sec. & Exch. Comm’n v. Andrade*, 157 F.Supp.3d 124, 128 (D.R.I. 2016).

10. *United States v. Stewart*, 15-CR-00287 (S.D.N.Y.), Dkt. No. 64 at 13 (Jan. 19, 2016).

11. *Id.* at Dkt. No. 174 at 32.