

Regulators Are Setting Sights On Crypto Market Manipulation

By **Douglas Yatter, Matthew Valenti and Deric Behar**

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Multiple U.S. government agencies have pursued a stream of enforcement actions in the digital asset industry in recent years.

In fiscal year 2022, 20% percent of the enforcement actions brought by the Commodity Futures Trading Commission involved digital assets.[1] The U.S. Securities and Exchange Commission has similarly highlighted its continuing focus on the sector,[2] as has the U.S. Department of Justice.[3]

Until recently, enforcement actions involving digital assets have tended to focus on two areas: registration and compliance violations, and retail fraud.

The former category generally involves businesses or individuals conducting unregistered securities offerings or providing a regulated product or service without being registered to do so. The latter category, broadly speaking, pertains to false or misleading statements and the misappropriation of customers' or investors' funds.

In the past year, enforcement agencies have also begun to focus on other types of misconduct involving digital assets.[4] One such area is market manipulation, and in the past year, the DOJ, CFTC and SEC each pursued cases alleging manipulation of the prices of digital assets.

The advent of this type of action has not yet received broad attention, perhaps because most of these cases also involved other types of conduct that may have obscured this novel set of claims. This article discusses five recent cases of note and offers insights into this emerging area of enforcement.

United States v. Kumbhani: The BitConnect Case

The first case of note began with an SEC complaint filed on Sept. 1, 2021, against online crypto lending platform BitConnect Ltd., its founder Satish Kumbhani, and promoter Glenn Arcaro and his company Future Money Ltd.

The complaint alleged that the defendants defrauded retail investors of \$2 billion through a fraudulent and unregistered offering of investments in a program involving digital assets.[5]



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According to the SEC's complaint, from 2017 to 2018, the defendants fraudulently offered unregistered securities in the form of investments in a "lending program" on BitConnect.[6]

On Feb. 25, 2022, the DOJ followed with an indictment of Kumbhani that added a new dimension.[7] In addition to the fraud charges described above, the indictment alleged that Kumbhani conspired with others to commit commodity price manipulation under the Commodity Exchange Act.

In support of the manipulation claim, the government claimed that Kumbhani "directed his network of promoters to fraudulently manipulate and prop up the price of BitConnect's digital currency," BitConnect Coin, in order to "create the false appearance of legitimate market demand for BCC." [8]

The indictment alleged that BCC is a commodity in interstate commerce.[9]

This was the first in the string of cases in the past year alleging manipulation in digital asset markets.

SEC v. The Hydrogen Technology: The Hydro Case

On Sept. 29, 2022, the SEC filed a complaint against a fintech firm, its CEO and the CEO of a market-making firm with whom it contracted,[10] alleging that the defendants participated in unregistered sales of Hydrogen's Hydro token and engaged in a scheme to manipulate the trading volume and price of the tokens.[11]

According to the SEC, Hydrogen Technology Corp. hired Moonwalkers Trading Ltd., a market-making firm based in South Africa, "to create the false appearance of robust Hydro trade volume" through the use of a customized trading bot and then selling Hydro into the artificially inflated market for profit on Hydrogen's behalf.[12]

Hydrogen purportedly participated in the scheme by "continuously allocating Hydro [tokens] (and bitcoin and [ethereum]) for [the market-maker] to use" in furtherance of the scheme and "holding regular calls with [the market-maker] to ensure [Hydrogen's] objectives were being met." [13]

Alleging that the Hydro token was a security, the complaint asserted that this scheme violated Section 17(a) of the Securities Act and Sections 9(a)(2) and 10(b) of the Securities Exchange Act.[14]

In announcing this case, the chief of the SEC Enforcement Division's Market Abuse Unit noted that "the SEC is committed to ensuring fair markets for all types of securities and will continue to expose and hold market manipulators accountable." [15]

CFTC v. Todd: The Digitex Case

On Oct. 3, 2022, the CFTC filed a complaint alleging that a digital asset derivatives platform and its founder illegally offered futures transactions to U.S. customers without being registered and failed to comply with certain regulatory requirements.[16] Beyond these charges, however, the CFTC also claimed that the defendants engaged in attempted market manipulation.

Beginning in January 2018, Digitex created and sold its own token, DGTX, which market participants had to own to trade on the Digitex platform. According to the complaint, for a period of 3 1/2 months in 2020, the defendants "attempted to manipulate the price of DGTX." [17]

The CFTC's claim of attempted manipulation relies on purported "non-economic trading activity," or "trading that was expected to lose money rather than make money," on third-party trading platforms in order to drive up the price of DGTG.[18]

The trading on third-party platforms, according to the complaint, "was intended to increase the market price that was reflected on those exchanges, which in turn was incorporated into the price of DGTG as reported by [a third-party data source]," which Digitex then used as the price at which it sold DGTG to market participants.[19]

The CFTC cited communications and social media posts in which the defendant promoted the token and "explained his intention to influence the price of DGTG." [20] And while the CFTC claimed only attempted manipulation, it also alleged that, in fact, "the price of DGTG rose sharply" during the period at issue.[21]

Based on these allegations, the CFTC charged the defendants with attempting to manipulate the price of DGTG, which it claimed to be a commodity.[22]

Upon filing the complaint, the acting director of the CFTC Division of Enforcement noted that "the CFTC will vigorously investigate potential manipulative trading activity to ensure confidence in markets remains strong." [23]

SEC v. Ellison and Wang: The FTX Case

On Dec. 21, 2022, the SEC filed a complaint against Caroline Ellison and Zixiao "Gary" Wang related to their role in a purported fraud involving crypto asset trading platform FTX and its former CEO Sam Bankman-Fried, as well as Alameda Research, a hedge fund associated with them.[24]

As has been widely reported, the complaint alleged that Ellison and Wang "engaged in a scheme to defraud equity investors" in FTX "at the same time that they were also defrauding the platform's customers." [25]

Receiving comparatively less attention was the SEC's claim that, as part of this scheme, the defendants manipulated the price of FTT, a token created by FTX.[26]

The complaint alleged that they manipulated the price of FTT by "purchasing large quantities of FTT on the open market to prop up its price," with the goal of preventing "the psychological effect [on the market or investors] of the price of FTT dropping below a specific threshold." [27]

And because Alameda held significant amounts of FTT and used it as collateral for loans from third parties, the purportedly inflated FTT prices enabled them to conceal "Alameda's true risk exposure from ... lenders, and [mislead] investors about FTX's risk exposure." [28]

The SEC claimed that FTT was "sold as an investment contract and therefore a security." [29] Based on these and other allegations, the SEC charged the defendants with fraud in the offer and sale of securities.[30]

Mango Markets

Finally, the end of 2022 and the beginning of 2023 brought the first actions targeting purported

manipulation involving a decentralized finance protocol.

In a series of three cases, the DOJ, CFTC and SEC each alleged that Avraham Eisenberg engaged in manipulative activity relating to the Mango Markets decentralized cryptocurrency platform.

First, on Dec. 23, 2022, the U.S. Attorney's Office for the Southern District of New York unsealed a criminal complaint against Eisenberg in connection with his trading of contracts called "perpetuals" involving the MNGO token.[31]

MNGO is the native token of the Mango Markets protocol, and the value of a MNGO perpetual depends on the relationship between the price of MNGO and the USDC, or US Dollar Coin, stablecoin. Mango Markets allowed users to borrow other cryptocurrencies based on the value of the borrower's portfolio.

The complaint claimed that in October 2022, Eisenberg entered into a significant amount of MNGO perpetuals using two different MNGO accounts that he controlled. He then purportedly purchased large amounts of MNGO on multiple platforms, which artificially increased the value of MNGO relative to USDC, and therefore the value of the MNGO perpetuals that he had purchased.

This scheme allowed him to borrow and withdraw approximately \$110 million worth of various cryptocurrencies from Mango Markets. The complaint said Eisenberg "had no intention to repay the borrowed funds" and that he admitted to the scheme in a series of social media posts.[32]

Based on these allegations, the criminal complaint and a subsequent indictment set forth charges against Eisenberg for commodities fraud and manipulation in violation of the Commodity Exchange Act.[33]

On Jan. 9, 2023, the CFTC filed a parallel civil complaint charging Eisenberg with manipulation based on the same conduct. Like the DOJ, the CFTC alleged that Eisenberg artificially inflated the value of Mango Markets' perpetual contracts.[34]

The CFTC noted that this complaint marked its first enforcement action to allege fraudulent or manipulative trading on a decentralized platform, characterizing the scheme as manipulation of the "oracle" code used to establish prices on the Mango Markets protocol.[35]

Although Eisenberg's purported scheme involved the MNGO token, neither the DOJ nor the CFTC took a position on what type of asset MNGO is. Instead, they based their charges on allegations that USDC is a commodity and that MNGO perpetuals are swaps under the Commodity Exchange Act.

On Jan. 20, 2023, the SEC weighed in with its own action against Eisenberg, setting out claims of manipulation and fraud in the purchase or sale of the MNGO token based on the same conduct described in the DOJ and CFTC actions, but alleging that the MNGO token is a security.[36]

In its complaint, the SEC asserted that the MNGO token was an investment contract, and hence a security, at the time of Eisenberg's purported manipulative conduct.[37]

Like the DOJ and CFTC, the SEC alleged that Eisenberg admitted his actions on social media, at one point stating that his conduct constituted "a highly profitable trading strategy." [38]

In an SEC press release announcing the enforcement action, the chief of the SEC's Crypto Assets and

Cyber Unit said the case illustrates that "the SEC remains committed to rooting out market manipulation, regardless of the type of security involved." [39]

Key Takeaways

The BitConnect, Hydro, Digitex, FTX and Mango Markets cases, all filed within the past year, represent a new phase in the U.S. government's digital asset enforcement efforts.

The breadth of these cases is noteworthy, as together they involve civil and criminal enforcement against individuals and entities for both domestic and international conduct, targeting alleged issuers and promoters as well as traders. They also deal with trading on a range of platforms, including centralized exchanges and a decentralized protocol.

Perhaps most notable, however, is that they allege manipulative conduct involving assets purported to be securities (Hydro and FTX), commodities (BitConnect and Digitex) or both (Mango Markets).

In manipulation cases, because the relevant statutes are specific to securities and commodities, the government must, among other requirements, stake out a view on the nature of one or more assets at issue. This contrasts with the DOJ's recent digital asset cases alleging insider trading, in which the agency used general fraud statutes without classifying the assets at issue. [40]

One may wonder how the agencies determined in bringing their respective manipulation cases that Hydro, FTT and MNGO are securities, while BCC and DGTX — as well as USDC — are commodities, when the cases involved similar allegations about how assets were created, sold, marketed, traded and used.

In this way, the new wave of enforcement cases alleging manipulation may compound confusion about how to determine whether digital assets are securities or commodities. These cases will also present other novel issues about the scope and applicability of the relevant statutes in digital asset markets.

Notwithstanding the novel issues they present, however, these cases show that U.S. enforcement agencies are on the lookout for market conduct that may involve the manipulation of digital assets.

Drawing on data analytics, whistleblower reports, and other tools, the agencies will look to expand their ability to detect and deter such conduct. The digital asset industry may therefore see more cases like these in the years ahead.

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[1] See CFTC Release No. 8613-22, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), <https://www.cftc.gov/PressRoom/PressReleases/8613-22>.

[2] See SEC Release No. 2022-206, SEC Announces Enforcement Results for FY22 (Nov. 15, 2022), <https://www.sec.gov/news/press-release/2022-206>.

[3] See DOJ Year in Review 2021, Fraud Section (Feb. 2022), <https://www.justice.gov/criminal-fraud/file/1472076/download>; DOJ Release No. 21-974, Deputy Attorney General Lisa O. Monaco Announces National Cryptocurrency Enforcement Team (Oct. 6, 2021), <https://www.justice.gov/opa/pr/deputy-attorney-general-lisa-o-monaco-announces-national-cryptocurrency-enforcement-team>.

[4] See, e.g., DOJ Release No. 22-180, Former Employee of NFT Marketplace Charged in First Ever Digital Asset Insider Trading Scheme (June 1, 2022) (describing charges in first insider trading case involving digital assets), <https://www.justice.gov/usao-sdny/pr/former-employee-nft-marketplace-charged-first-ever-digital-asset-insider-trading-scheme>.

[5] SEC Release No. 2021-172, SEC Charges Global Crypto Lending Platform and Top Executives in \$2 Billion Fraud (Sept. 1, 2021), <https://www.sec.gov/news/press-release/2021-172>.

[6] Complaint para. 1, SEC v. BitConnect, Satish Kumbhani, et al., No. 21-CV-07349 (S.D.N.Y. Sept. 1, 2021). In a parallel criminal action, BitConnect promoter Glenn Arcaro pleaded guilty to conspiracy to commit wire fraud. DOJ Release No. CAS21-0901-Arcaro, Director and Promoter of BitConnect Pleads Guilty in Global \$2 Billion Cryptocurrency Scheme (Sept. 1, 2021), <https://www.justice.gov/usao-sdca/pr/director-and-promoter-bitconnect-pleads-guilty-global-2-billion-cryptocurrency-scheme>.

[7] DOJ Release No. 22-171, BitConnect Founder Indicted in Global \$2.4 Billion Cryptocurrency Scheme (Feb. 25, 2022), <https://www.justice.gov/opa/pr/bitconnect-founder-indicted-global-24-billion-cryptocurrency-scheme>.

[8] *Id.*

[9] Indictment, United States v. Kumbhani, No. 22-CR-395 (S.D. Cal. Feb. 25, 2022), <https://www.justice.gov/criminal-fraud/file/1523621/download>.

[10] SEC Release No. 2022-175, SEC Charges The Hydrogen Technology Corp. and Its Former CEO for Market Manipulation of Crypto Asset Securities (Sept. 28, 2022), <https://www.sec.gov/news/press-release/2022-175>.

[11] Complaint paras. 131-40, SEC v. The Hydrogen Technology Corp., et al., No. 22-CV-08284 (S.D.N.Y. Sept. 29, 2022), <https://www.sec.gov/litigation/complaints/2022/comp-pr2022-175.pdf>.

[12] *Id.* at para. 130.

[13] *Id.* at para. 116.

[14] *Id.* at paras. 155-58.

[15] SEC Release No. 2022-175, *supra* note 10. Without admitting or denying the allegations, the CEO of the market-making firm consented to a judgment enjoining him from future violations and ordering him to pay disgorgement, receive an industry bar, and pay civil penalties to be determined later. Judgment as to Defendant Tyler Ostern, *SEC v. The Hydrogen Technology Corp., et al.*, No. 22-CV-08284 (S.D.N.Y. Sept. 29, 2022), <https://www.sec.gov/litigation/litreleases/2022/judg25553.pdf>. The remaining defendants have obtained extensions of their time to answer the complaint in light of settlement discussions with the SEC that may resolve the matter. No. 13-17, Civil Docket, *SEC v. Hydrogen Technology Corp., et al.*, https://ecf.nysd.uscourts.gov/cgi-bin/DktRpt.pl?132302475680765-L_1_0-1.

[16] CFTC Release No. 8605-22, CFTC Charges Digital Access Derivatives Platform and Miami Resident with Facilitating Unlawful Futures Transactions, Failing to Register, and Attempted Manipulation of Native Token (Oct. 3, 2022), <https://www.cftc.gov/PressRoom/PressReleases/8605-22>.

[17] *CFTC v. Adam Todd, Digitex LLC, Digitex Ltd., Digitex Software Ltd., & Blockster Holdings Ltd Corp. (d/b/a Digitex Futures)*, No. 22-CV-23174 (S.D. Fla. Sept. 30, 2022), at para. 7, <https://www.cftc.gov/media/7826/enfdigitexcomplaint093022/download>.

[18] *Id.* at para. 7.

[19] *Id.* at para. 57.

[20] *Id.* at paras. 58-72.

[21] *Id.* at para. 56.

[22] *Id.* at paras. 78-90.

[23] CFTC Release No. 8605-22, *supra* note 16.

[24] *SEC v. Caroline Ellison & Zixiao "Gary" Wang*, No. 22-CV-10794 (S.D.N.Y. Dec. 21, 2022), <https://www.sec.gov/litigation/complaints/2022/comp-pr2022-234.pdf>.

[25] *Id.* at para. 1.

[26] *Id.*

[27] *Id.* at paras. 74, 93.

[28] *Id.* at para. 94.

[29] *Id.* at para. 85.

[30] *Id.* at paras. 116-121.

[31] *United States v. Avraham Eisenberg*, No. 22-MJ-10337 (S.D.N.Y. criminal complaint unsealed Dec. 23, 2022).

32 *Id.* at paras. 4-6, 17.

[33] Id. at paras. 1-2; see also Indictment, United States v. Eisenberg, No. 23-CR-010 (S.D.N.Y. Jan. 9, 2023).

[34] CFTC v. Avraham Eisenberg, No. 23-CV-00173 (S.D.N.Y. complaint filed Jan. 9, 2023), <https://www.cftc.gov/media/8046/enfeisenbergcomplaint010923/download>.

[35] CFTC Release No. 8647-23, CFTC Charges Avraham Eisenberg with Manipulative and Deceptive Scheme to Misappropriate Over \$110 million from Mango Markets, a Digital Asset Exchange (Jan. 9, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8647-23>.

[36] SEC v. Avraham Eisenberg, No. 23-CV-503 (S.D.N.Y. complaint filed Jan. 20, 2023), <https://www.sec.gov/litigation/complaints/2023/comp-pr2023-13.pdf>.

[37] Id. at paras. 32, 39, 43-48.

[38] Id. at para. 105.

[39] SEC Release No. 2023-13, SEC Charges Avraham Eisenberg with Manipulating Mango Markets' "Governance Token" to Steal \$116 Million of Crypto Assets (Jan. 20, 2023), <https://www.sec.gov/news/press-release/2023-13>.

[40] DOJ Release No. 22-180, *supra* note 4; DOJ Release No. 22-232, *supra* note 4.