CADWALADER

Cabinet News and Views

Informed analysis for the financial services industry

DOJ, SEC and CFTC Announce Parallel Criminal and Civil Charges Against Sam Bankman-Fried, FTX Trading and Alameda Research

By Jodi L. Avergun
Partner | White Collar Defense and Investigations

By Peter Y. Malyshev
Partner | Financial Regulation

By Kendra Wharton
Associate | White Collar Defense and Investigations

On December 13, the U.S. Attorney's Office for the Southern District of New York (the "U.S. Attorney's Office"), the U.S. Securities and Exchange Commission (the "SEC"), and the U.S. Commodity Futures Trading Commission (the "CFTC") announced parallel criminal and civil actions (here, here and here) against FTX co-founder and former CEO Sam Bankman-Fried. The charges were made public the morning after the U.S. Attorney tweeted that Bankman-Fried had been arrested by Bahamian authorities at the request of the U.S. government.

Criminal Charges

A federal grand jury indicted Bankman-Fried on December 8, charging him in eight separate counts. The charges include conspiracies to commit wire fraud, commodities fraud, securities fraud, money laundering and federal campaign finance violations.

According to the indictment, Bankman-Fried perpetrated a multi-year scheme to defraud FTX customers by diverting billions of dollars of their crypto assets to his crypto trading firm, Alameda Research. Bankman-Fried is also alleged to have defrauded Alameda's lenders and equity investors in FTX by concealing his misuse of customer crypto, some of which are alleged to be the true source of millions of dollars in political contributions.

Bankman-Fried is being held without bail in the Bahamas pending the filing of a formal extradition request. An extradition process is usually lengthy, and it might be many months before Bankman-Fried can be prosecuted in a U.S. court. At a hearing on December 13, Bankman-Fried indicated that he plans to fight extradition at this time, but he may ultimately waive that right and agree to be transferred to the U.S. to begin judicial proceedings. Bankman-Fried's appearance in the U.S. may also be delayed if Bahamian authorities pursue charges under Bahamian law.

In addition to the possibility of a lengthy prison sentence, Bankman-Fried faces potential asset forfeiture of any property derived from the proceeds of his alleged crimes.

SEC Allegations

The SEC's complaint, filed in the U.S. District Court for the Southern District of New York, alleges that Bankman-Fried defrauded equity investors in FTX by misrepresenting that FTX was a safe, responsible crypto asset trading platform. For example, the SEC alleges that Bankman-Fried repeatedly told prospective investors that FTX had sophisticated risk management controls in place to protect customer assets, and that those assets were safe and secure, but his statements were false and misleading because he had exempted Alameda from the risk management measures and was diverting billions in crypto assets to prop up Alameda's operations. The SEC alleges that these and other actions amounted to securities fraud in violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

The SEC is seeking a permanent injunction against Bankman-Fried, disgorgement of ill-gotten gains, civil money penalties, an officer and director bar, and an order prohibiting Bankman-Fried from participating in any future offer or sale of securities (including crypto asset securities).

CFTC Allegations

Unlike the criminal and SEC actions, the CFTC's complaint alleges multiple federal violations by Bankman-Fried, as well as FTX Trading and Alameda Research. The CFTC's complaint is very similar to those filed by the DOJ and the SEC; however, the scope of the complaint and the legal authorities relied by the CFTC are materially different.

- First, the CFTC asserted that virtual currencies, such as Bitcoin, Ether and Tether, are recognized as "commodities" as defined in Section 1a(9) of the Commodity Exchange Act of 1936 (the "CEA") and CFTC regulations thereunder.

- Second, the CFTC charged that FTX's actions materially impacted the trading of crypto assets, as well as certain futures contracts on these assets that are traded on registered derivative commodity exchanges.

- Third, the CFTC alleged that FTX's asset transfers to Alameda constituted fraud and that FTX engaged in fraudulent misstatements of material fact and material omissions "in connection with contracts of sale of commodities in interstate commerce" in violation of Section 6c(1), and CFTC regulations Section 180.1(a)(1), (2) and (3), thus triggering CFTC's general antifraud enforcement jurisdiction in connection with commodities generally.

Notably, the CFTC made clear that FTX's U.S. CFTC-registered platforms ("FTX US Derivatives") (formerly known as "LedgerX") were registered with and fully regulated by the CFTC as a designated contract market, a derivatives clearing organization and swap execution facility, that "maintained separate bank accounts which segregated and accounted for customer funds at all relevant times." Accordingly, the U.S. platforms are not within the scope of this complaint.

Final Thoughts

Despite recent focus on whether many crypto assets can be regulated under the federal securities laws or the CEA, the criminal and civil actions announced on December 13 do not require any finding that crypto assets listed by FTX were securities or commodity derivatives (such as futures, options or swaps). Rather, they focus on time-tested legal theories of fraud. However, the U.S. Attorney's Office, the SEC and the CFTC have indicated that investigations into other possible misconduct are still ongoing.