

# Criminal Vs. Civil Liability Amid Growing Crypto Enforcement

By **Preet Bharara, Robert Boone and Tiffany Smith** (January 6, 2023)

The emergence of digital assets has brought new risks and challenges, including the potential exploitation of the technology to facilitate financial crime.

The U.S. Department of Justice has committed to work with its law enforcement and regulatory partners to "[advance] the responsible development of digital assets, protecting the public from criminal actors in this ecosystem, and meeting the unique challenges these technologies pose."[1]

On the heels of Executive Order No. 14067 on responsibly developing digital assets,[2] the DOJ broadcast a series of new initiatives in furtherance of these efforts.[3]

Of note, on Sept. 16, 2022, the DOJ announced the creation of the Digital Asset Coordinator, or DAC, Network — a network of more than 150 prosecutors from U.S. attorney's offices and the DOJ's litigating components — which "will serve as the department's primary forum for prosecutors to obtain and disseminate specialized training, technical expertise, and guidance about the investigation and prosecution of digital asset crimes."[4]

These additional resources and specialized training will likely result in a greater number of DOJ investigations, so crypto market participants should understand both how the tools of the DOJ vary from those of its regulatory partners, as well as the theories of liability that the DOJ may pursue alongside those partners in parallel actions.

As the BitMEX case and other recent cases discussed below demonstrate, crypto entities or individuals at the helm of those entities can be subject to legal action on multiple legal theories and jurisdictional bases.

## Digital Asset Coordinator Network

The creation of the DAC Network by the DOJ's Criminal Division reflects the continuing focus on the challenges posed by the illicit use of digital assets.

As noted in the press release announcing the network, the DAC Network is led by the DOJ's National Cryptocurrency Enforcement Team, "in close coordination with the Criminal Division's Computer Crime and Intellectual Property Section and the Money Laundering and Asset Recovery Section's Digital Currency Initiative."[5]

Each DAC will serve as the subject matter expert on digital assets for their respective office and be a resource within their office, providing information and guidance about legal and technical matters related to digital assets.[6]

The implications of the DOJ adding additional resources to address the illicit use of digital assets should not be understated. A new network backed by additional expertise and



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presidential decree will likely result in a dramatic increase in DOJ investigations and enforcement.

Thus, the crypto industry, including individuals leading crypto entities, should take note of this development and understand the potential implications.

Indeed, one day before the DAC announcement, Deputy Attorney General Lisa Monaco issued a memorandum emphasizing that the DOJ's first priority in corporate enforcement is individual accountability.[7]

As seen in prior DOJ actions, prosecutors have been anything but gun-shy about pursuing individual crypto executives and founders; this trend shows no signs of reversing.

### **Criminal Versus Civil Enforcement**

While the DAC Network reflects a DOJ with its sights set on crypto, industry players should remain cognizant of the potential for parallel civil enforcement actions — at both the federal and state level — often based on the same constellation of facts.

This is because, while their jurisdictions are distinct, criminal and civil authorities frequently collaborate on, and/or refer one another, cases where there is potential for both civil and criminal liability.

The BitMEX case is a useful example.[8] BitMEX is an online peer-to-peer cryptocurrency derivatives exchange founded by Arthur Hayes, Ben Delo and Samuel Reed and registered in the Seychelles. At one time, it was the largest cryptocurrency derivatives exchange in the world.[9]

BitMEX was required to register with the U.S. Commodity Futures Trading Commission and implement an anti-money laundering program, including know-your-customer procedures under the Bank Secrecy Act.[10]

BitMEX did not institute an AML program, however, and failed to verify its customers' identities, instead allowing them to trade using only an email address.[11]

On Oct. 1, 2020, the U.S. Attorney's Office for the Southern District of New York unsealed an indictment against the three founders of BitMEX, as well as a fourth individual who served various leadership roles within the company, for willfully causing, aiding, abetting and conspiring to commit violations of the BSA.[12]

Simultaneous with the Southern District of New York indictment, the CFTC filed an enforcement action against the five companies that operate BitMEX, and its three founders, for "operating an unregistered trading platform and violating multiple CFTC regulations." [13]

On Aug. 10, 2021, the Financial Crimes Enforcement Network and the CFTC jointly announced that they had assessed a \$100 million civil monetary penalty against the companies operating BitMEX.[14]

Each of the three founders of BitMEX and the fourth individual later pled guilty to willfully violating the BSA, agreed to pay a criminal fine, and were sentenced to terms of home detention and/or probation.

As the BitMEX case illustrates, companies may be prosecuted by the DOJ alongside civil actions taken by agencies such as FinCEN and the CFTC. And there are others. For example, the DOJ and the U.S. Securities and Exchange Commission have coordinated in recent years on allegedly fraudulent initial coin offerings. And state regulators, like the New York Department of Financial Services and New York Attorney General's Office, have also been active enforcers in this space.

Still, while companies should certainly consider the possibility of parallel criminal and civil investigations, the tools that the DOJ has at its disposal are far broader and more intrusive than those of the regulatory agencies.

While regulatory agencies can open investigations; issue subpoenas to request documents or testimony; and impose civil penalties such as industry suspensions and bars, civil monetary penalties and disgorgement, criminal authorities can employ much more coercive and intrusive means.

These include, among other things, search warrants; surveillance, e.g., wiretaps, eavesdropping bugs, confidential informants and cooperators; and grand jury subpoenas.

And, with the announcement of the DAC Network, the DOJ has affirmed its intention to ensure that prosecutors learn about the full suite of investigative tools, including "the application of existing authorities and laws to digital assets ... for drafting search and seizure warrants, restraining orders, criminal and civil forfeiture actions, indictments, and other pleadings." [15]

Since the DOJ has already been an active enforcer in the crypto sphere, the additional resources and specialized training will likely significantly increase the number of investigations opened by the department.

## **Common Theories of Liability**

### ***Wire Fraud***

One of the principal and perhaps broadest tools prosecutors have at their disposal is the wire fraud statute.

In March 2022, the Southern District of New York charged Ethan Nguyen and Andre Llacuna — who launched a nonfungible token collection called Frosties, ice cream scoop cartoon characters that sold out within an hour — with conspiracy to commit wire fraud and conspiracy to commit money laundering. [16]

According to the complaint, Nguyen and Llacuna are alleged to have transferred \$1.1 million in proceeds from the sale of the Frosties to their own crypto wallets, after which they abruptly abandoned the project and shut down the Frosties website. [17] This type of scheme is colloquially known as a rug pull.

This use of wire fraud is a well-trodden path. Historically, in complex and emergent areas of the law, prosecutors have turned to the far-reaching and adaptable wire fraud statute.

Indeed, the DOJ used wire fraud in a crypto case again a few months after the Frosties case in *U.S. v. Wahi*. Ishan Wahi, a former product manager at Coinbase Global Inc., Ishan's brother Nikhil Wahi, and Ishan's friend Sameer Ramani were charged with conspiracy to commit wire fraud and wire fraud in connection with an insider trading scheme. [18]

The indictment alleges that Ishan transmitted confidential Coinbase information about which crypto assets were scheduled to be listed on Coinbase's exchange to Nikhil and Ramani so that they could purchase those assets in advance of Coinbase's public listing announcements and sell them after for a higher price.[19]

On Aug. 3, 2022, Ishan and Nikhil pled not guilty. On Sept. 12, 2022, Nikhil pled guilty to one count of conspiracy to commit wire fraud.[20] Ramani continues to dispute the charges against him.

### ***Securities and Commodities Fraud***

Parallel to the criminal action, the SEC initiated civil proceedings against the Wahi defendants, alleging violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5.[21] The SEC alleges that certain of the crypto assets involved were crypto asset securities, thus setting the stage for a debate about whether the crypto assets in questions are securities as alleged in the SEC's complaint.

Wahi demonstrates a comparative advantage the DOJ has in the crypto sphere: The criminal wire fraud statute "reach[es] any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises," as held by the U.S. Supreme Court's 1987 decision in *Carpenter v. U.S.*, regardless of whether the scheme involves securities.

Thus, the DOJ need not get enmeshed in the jurisdictional debate about whether and when crypto assets are securities or commodities.

### ***Bank Secrecy Act Violations***

Prosecutors and regulators alike may also harness the BSA to go after crypto platforms. Under the BSA, financial institutions must establish and maintain, among other things, an AML program that meets certain minimum standards. A willful failure to do so can be criminally prosecuted.

The BitMEX case, described above, provides a telling example of how the BSA can be deployed.

In that case, BitMEX received notice that the platform was being used to launder proceeds of a cryptocurrency hack. Nevertheless, the company neither filed a suspicious activity report nor implemented an effective AML compliance program, despite a legal obligation to do so. As a result, the DOJ determined that BitMEX became "in effect a money laundering platform." [22]

### ***Sanctions Violations***

According to the DOJ, BitMEX also served as a vehicle to evade sanctions. Two of the company's founders communicated directly with the exchange's customers "who self-identified as being based in Iran, an [Office of Foreign Assets Control]-sanctioned jurisdiction, but did nothing to implement an AML or KYC program after doing so." [23]

The BitMEX case is not the only one in which the DOJ and/or OFAC — an agency charged with administering and enforcing economic and trade sanctions — has alleged that individuals or entities have used crypto to try to conduct transactions with sanctioned

entities.

OFAC guidance provides that U.S. economic sanctions cover cryptocurrency transactions.[24] And the DOJ is responsible for enforcing criminal penalties for willfully violating those sanctions.

For example, last April in *U.S. v. Griffith*, the U.S. District Court for the Southern District of New York sentenced 39-year-old Virgil Griffith to 63 months in prison after he pled guilty to conspiracy to violate the International Emergency Economic Powers Act.[25]

Griffith traveled to the Democratic People's Republic of Korea, a country subject to extensive U.S. sanctions, in order to help the country develop and fund cryptocurrency infrastructure.

Even though the U.S. Department of State denied Griffith permission to travel to North Korea, he went anyway, providing instruction on how the country could harness blockchain and cryptocurrency technology to launder money and evade sanctions.

Griffith argued that his presentation was not subject to the IEEPA because he was not paid, but this argument was rejected, and Griffith decided to plead guilty.

### **Concluding Thoughts**

While the above-cited examples do not represent the full complement of statutory authority under which criminal and civil authorities can prosecute cases in the crypto sphere, they show a DOJ that is willing to retrofit familiar laws to pursue a new technology.

And the announcement of the DAC Network likely portends even more aggressive criminal enforcement in the area, in addition to the continued focus of regulatory agencies. Crypto market participants should take note of this focus and understand the potential implications.

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