

5 Things To Note In Charges Against FTX's Bankman-Fried

By **Jason Covert** (December 15, 2022)

On Dec. 13, the U.S. Department of Justice, U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission unveiled separately filed charges against Samuel Bankman-Fried, the co-founder and former CEO of FTX Trading Ltd. and Alameda Research LLC.



Jason Covert

The SEC's 28-page civil complaint[1] charges Bankman-Fried with fraud in the offer or sale of securities under the Securities Act of 1933,[2] and fraud in connection with the purchase or sale of securities under the Securities Exchange Act and Rule 10b-5.[3]

The CFTC's 40-page civil complaint[4] charges Bankman-Fried, FTX and Alameda with fraud[5] and fraudulent misstatements of material fact and material omissions under the Commodity Exchange Act and regulations.[6]

By comparison, the DOJ's relatively slim eight-count criminal indictment[7] spans just 14 pages, charging Bankman-Fried with multiple counts of conspiracy to commit wire fraud,[8] multiple substantive counts of wire fraud,[9] conspiracy to commit commodities fraud,[10] conspiracy to commit securities fraud,[11] conspiracy to commit money laundering,[12] and conspiracy to defraud the U.S. and violate campaign finance laws.[13]

What is clear from all three charging instruments is that each agency believes that it has sufficient evidence to prove that Bankman-Fried devised and directed a fraudulent scheme that began when FTX was first created and continued until its bankruptcy in November — a scheme involving misrepresentations to customers, investors and lenders about, among other things, the use of FTX customer funds, the operations of FTX and Alameda, and the solvency and value of FTX and Alameda.

Takeaways

Here are five takeaways from a review of the agencies' respective charging instruments:

1. The government has charged a classic theory of fraud based on misappropriation and misrepresentations.

While much has been made about the complexity of cryptocurrency and blockchain analysis, the government's theory of prosecution against Bankman-Fried is relatively simple and straightforward: theft and lies.

In the government's theory of prosecution, cryptocurrency is ancillary to the fraud — a MacGuffin of sorts.[14] A review of the charges contained in the respective charging instruments requires little expertise in the field of cryptocurrency, digital assets or blockchain analysis to understand why Bankman-Fried finds himself in overlapping civil and criminal jeopardy.

The SEC and CFTC complaints contain pages of detailed allegations explaining how Bankman-Fried directed the misappropriation of FTX customer funds, made material misrepresentations to investors to raise funds, and concealed his allegedly fraudulent

conduct.

The criminal indictment similarly alleges that Bankman-Fried misappropriated customer funds, provided false and misleading information to third parties and the government, and conspired with others to engage in that same misconduct.

While the pleadings generally discuss the cryptocurrency industry, one could just as easily replace that discussion with residential mortgage-backed securities, oil and gas ventures, or even a novel blood-testing technology and see that the government has employed an oft-used theory of greed and deceit to prosecute this matter.

The decision to charge a classic theory of fraud based on misappropriation, misrepresentations and acts of concealment allowed the government to bring charges quickly and will provide significant jury appeal because it can be conveyed easily and with conviction to jurors who may have no understanding of cryptocurrency itself.

2. The speed of the charges reflects the DOJ's confidence in its evidence.

Although the factual allegations in the criminal indictment are thin, the simultaneously filed regulatory complaints reveal the types of evidence the government obtained and developed during the investigation, including internal FTX documents, such as chats, emails, accounting ledgers and investment materials; public-facing statements by Bankman-Fried; and witness statements, likely including one or more cooperating co-conspirators.

While it is unclear precisely when the government began investigating FTX, Bloomberg News has reported that a criminal probe of multiple cryptocurrency platforms, including FTX, had begun months before FTX's collapse, but that the trajectory of the investigation changed as FTX publicly unraveled.[15]

Even assuming prosecutors have been investigating FTX for months, the DOJ's decision to present an indictment against Bankman-Fried just 32 days after FTX's collapse is surprising and speaks to the DOJ's confidence in the evidence it has developed.

Before making a recommendation to bring charges, federal prosecutors are bound to conduct a review of their evidence to determine whether it is sufficient to sustain a conviction.

Section 9-27.220 of the DOJ's Justice Manual states that

both as a matter of fundamental fairness and in the interest of the efficient administration of justice, no prosecution should be initiated against any person unless the attorney for the government believes that the admissible evidence is sufficient to obtain and sustain a guilty verdict by an unbiased trier of fact.[16]

Accordingly, most complex financial investigations, like the one into FTX, take years to produce sufficient evidence for a prosecutor to feel comfortable recommending charges and presenting an indictment to a grand jury.

For instance, Reuters recently reported that DOJ prosecutors have been investigating allegations of money laundering, sanctions evasion and unlicensed money transmission involving another cryptocurrency exchange, Binance Holdings Ltd., since 2018.[17]

The article notes that while

[s]ome of the at least half dozen federal prosecutors involved in the case believe the evidence already gathered justifies moving aggressively against the exchange and filing criminal charges against individual executives including founder Changpeng Zhao, ... [o]thers have argued taking time to review more evidence.

In comparison, the relatively lightning-fast charges brought against Bankman-Fried indicate the government's perception of the strength of its evidence.

3, The government believes that Bankman-Fried was principally responsible for the scheme to defraud.

It is clear from the indictment and the regulatory complaints that the government believes Bankman-Fried was the primary culprit responsible for numerous misrepresentations and the decision to misappropriate FTX customer funds, as well as other misconduct.

For instance, the SEC complaint contains detailed factual allegations supporting its charge that Bankman-Fried orchestrated a "massive, years-long fraud" through directions and instructions to divert customer funds and by directly making material misstatements to investors and customers of FTX.[18] The CFTC complaint contains similar factual allegations of Bankman-Fried's direct role in perpetrating the fraud.[19]

While the criminal indictment against Bankman-Fried contains little in the way of factual allegations, one can still find indications of the DOJ's evidence related to Bankman-Fried's role in the scheme.

For instance, counts 3 and 4 of the indictment — charging conspiracy to commit wire fraud and substantive wire fraud, respectively — are based on the same alleged scheme to defraud lenders by providing false and misleading information regarding Alameda's financial condition.

While the substantive wire fraud count alleges that Bankman-Fried engaged in this scheme from 2019 through this November, the corresponding conspiracy count alleges that it was not until June of this year that at least one other person agreed to defraud Alameda's lenders with Bankman-Fried, thus forming a conspiracy.

The difference in the temporal scope of the conspiracy count and the substantive count indicates that the government intends to prove Bankman-Fried devised and executed the fraudulent scheme for more than two years before bringing other co-conspirators into the scheme.

This interpretation of the DOJ's charging construction is consistent with the detailed factual allegations contained in the SEC and CFTC complaints, which unequivocally allege that Bankman-Fried was principally responsible for the alleged scheme to defraud at FTX.

However, the complaints and indictment all allege that others eventually participated in this scheme as well, making the government's decision to first charge Bankman-Fried alone an important one.

The government's decision to do so while also detailing the participation of other individuals is likely a signal to the remaining subjects and targets of the investigation that there is a brief window to resolve their criminal and regulatory exposure, or risk finding themselves named in a superseding indictment or amended complaint.

4. The government intends to use Bankman-Fried's public statements as admissions of a party opponent.

A common problem encountered in fraud investigations is attributing false and misleading corporate statements to a specific individual. But in the case of FTX, Bankman-Fried's prolific participation in speaking engagements, on-the-record interviews and use of Twitter to promote and defend FTX and himself has significantly eased that burden for the government.

Moreover, during the collapse of FTX, when many observers expected Bankman-Fried to stop making public statements, he instead continued to speak about FTX, Alameda and even his own failures.

Perhaps he did this to try to frame the narrative around FTX in the court of public opinion, but as the regulatory complaints reflect, he instead generated admissions that will be used against him in the court of law.[20]

Each of the public statements made by Bankman-Fried is arguably admissible in a criminal or civil action against him as an admission of party opponent under Federal Rule of Evidence 801(d)(2).

Furthermore, the government will likely be able to admit the particular excerpts or statements made by Bankman-Fried that it believes will benefit its case, while limiting the admission of larger portions of the statements that may exculpate him.

Bankman-Fried may attempt to admit additional exculpatory portions of those statements under Federal Rule of Evidence 106 and the rule of completeness, but district courts have broad discretion to exclude such evidence and will often instead require a defendant to testify, subjecting him to cross-examination, if he wishes to admit such statements.[21]

5. There may be discovery consequences that flow from a joint investigation finding.

In a criminal prosecution, the DOJ has discovery obligations pursuant to Federal Rule of Criminal Procedure 16; the U.S. Supreme Court's 1963 decision in *Brady v. Maryland*[22] and 1972 decision in *Giglio v. U.S.*:[23] and the Jencks Act.[24]

As a general rule, these discovery obligations only extend to material in the possession, custody or control of the prosecution team, not to agencies or individuals outside of the prosecution team.[25]

However, where the government conducts a joint investigation with other agencies, a prosecutor's discovery obligations may require her to review documents in the possession, custody or control of the agency or agencies with which the criminal authorities conducted the joint investigation.[26]

In *U.S. v. Collins*, the U.S. District Court for the Southern District of New York found in 2019 that

[a] number of factors are relevant in determining whether the prosecution conducted a "joint investigation," including whether the other agency: (1) participated in the prosecution's witness interviews, (2) was involved in presenting the case to the grand jury, (3) reviewed documents gathered by or shared documents with the

prosecution, (4) played a role in the development of prosecutorial strategy, or (5) accompanied the prosecution to court proceedings.[27]

While the public can only speculate as to whether the agencies' FTX investigations were joint or parallel, there are several facts in the public record indicating this was a joint investigation.

Those facts include, among others:

- The coordinated effort of the agencies in filing[28] and unveiling their respective charges, with each agency announcing that the others agencies were also filing charges, which indicates that all three of the agencies had advance notice of their counterparts' charging recommendations and decisions;
- The recognition in each agency's press releases regarding the assistance provided by the other agencies,[29] including specifically the DOJ's press release stating that the FBI investigated the case with the assistance of the SEC and CFTC; and
- The significant overlap in factual allegations and legal theories contained in the three separate charging instruments, including with respect to specific internal FTX documents and statements made by witnesses, which indicates that the agencies likely engaged in joint fact-finding by sharing documents and participating in joint witness interviews.

Should the district court conclude that this was a joint investigation, the DOJ will have an obligation to gather, review and produce any material in the possession, custody or control of the SEC and CFTC that is subject to criminal discovery.

Such an obligation, while not impossible, is extremely cumbersome and increases the risk that a potentially harmful discovery issue may materialize during the litigation.

Jason Covert is a partner at Taft Stettinius & Hollister LLP. He previously served as a prosecutor in the DOJ's Criminal Division, Fraud Section.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Securities and Exchange Commission v. Samuel Bankman-Fried, 1:22-cv-10501 (S.D.N.Y.) (filed Dec. 13, 2022) [hereinafter SEC Complaint], available at <https://www.sec.gov/litigation/complaints/2022/comp-pr2022-219.pdf> (last visited Dec. 14, 2022).

[2] 15 U.S.C. § 77q(a).

[3] 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5.

[4] Commodity Futures Trading Commission v. Samuel Bankman-Fried, et al., 1:22-cv-10503 (S.D.N.Y.) (filed Dec. 13, 2022) [hereinafter CFTC Complaint], available at <https://www.cftc.gov/media/7986/enfftxtradingcomplaint121322/download> (last visited Dec. 14, 2022).

[5] 7 U.S.C. § 9(1) and 17 C.F.R. 180.1(a)(1), (3).

[6] 7 U.S.C. § 9(1) and 17 C.F.R. 180.1(a)(2).

[7] United States v. Samuel Bankman-Fried, 22-cr-673 (S.D.N.Y.) (unsealed Dec. 13, 2022), available at <https://www.justice.gov/usao-sdny/press-release/file/1557571/download> (last visited Dec. 14, 2022).

[8] 18 U.S.C. § 1349.

[9] 18 U.S.C. § 1343.

[10] 18 U.S.C. § 371.

[11] 18 U.S.C. § 371

[12] 18 U.S.C. § 1956(h).

[13] 18 U.S.C. § 371.

[14] In fiction, a MacGuffin is "an object, event, or character in a film or story that serves to set and keep the plot in motion despite usually lacking intrinsic importance." Merriam-Webster, available at <https://www.merriam-webster.com/dictionary/MacGuffin> (last viewed Dec. 14, 2022).

[15] Ava Benny-Morrison, US Prosecutors Opened Probe of FTX Months Before its Collapse, Bloomberg News (Nov. 21, 2022), available at <https://www.bloomberg.com/news/articles/2022-11-21/us-prosecutors-opened-probe-of-ftx-months-before-its-collapse?leadSource=uverify%20wall> (last visited Dec. 14, 2022).

[16] Department of Justice, Justice Manual, Section 9-27.220 Ground for Commencing or Declining Prosecution, available at <https://www.justice.gov/jm/jm-9-27000-principles-federal-prosecution#9-27.220> (last visited Dec. 14, 2022).

[17] Angus Berwick, Dan Levine, and Tom Wilson, U.S. Justice Dept is split over charging Binance as crypto world falters, Reuters, (Dec. 12, 2022) available at <https://www.reuters.com/markets/us/us-justice-dept-is-split-over-charging-binance-crypto-world-falters-sources-2022-12-12/> (last visited Dec. 14, 2022).

[18] See, e.g., SEC Complaint at ¶¶ 18, 26, 32, 40, 41, 45, 47, 53, 66, 71, 72.

[19] See, e.g., CFTC Complaint at ¶¶ 6-9, 51, 52, 64, 72, 77.

[20] See, e.g., SEC Complaint at ¶¶ 62 and 78; CFTC Complaint at ¶ 111.

[21] See *United States v. Williams*, 930 F.3d 44, 59–61 (2d Cir. 2019).

[22] *Brady v. Maryland*, 373 U.S. 83 (1963).

[23] *Giglio v. United States*, 405 U.S. 150 (1972).

[24] The Jencks Act, 18 U.S.C. § 3500.

[25] See *United States v. Blaszczak*, 308 F. Supp. 3d 736, 742 (S.D.N.Y. 2018).

[26] See *United States v. Collins*, 409 F. Supp. 3d 228, 239 (S.D.N.Y. 2019).

[27] *Id.* at 239 (internal quotation marks omitted).

[28] The SEC and CFTC complaints were filed so closely together in time that their respective case numbers are separated by just one other matter in the district.

[29] DOJ Press Release, FTX Founder Indicted for Fraud, Money Laundering, and Campaign Finance Offenses, available at <https://www.justice.gov/opa/pr/ftx-founder-indicted-fraud-money-laundering-and-campaign-finance-offenses> (last visited Dec. 14, 2022); SEC Press Release, SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX, available at <https://www.sec.gov/news/press-release/2022-219> (last visited Dec. 14, 2022); CFTC Press Release, CFTC Charges Sam Bankman-Fried, FTX Trading and Alameda with Fraud and Material Misrepresentations, available at <https://www.cftc.gov/PressRoom/PressReleases/8638-22> (last visited Dec. 14, 2022).