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SEC Files First Insider Trading Action Alleging Crypto Assets Are Securities

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On July 21, 2022, the Securities and Exchange Commission ("SEC") filed an insider trading case alleging for the first time that an employee's alleged tipping of material nonpublic information for purposes of trading crypto assets constitutes securities fraud.[1] Under this theory, the SEC's complaint alleges that certain cryptocurrencies were securities under the Securities Act of 1933 and the Securities Exchange Act of 1934, because the SEC claims they were investment contracts based on the fact that they were (a) "offered and sold to investors"; (b) "who made an investment of money in a common enterprise," and (c) "with a reasonable expectation of profits derived from the efforts of others."[2] In contrast, the United States Attorney's Office for the Southern District of New York ("SDNY")—the tip of the spear in the U.S. Department of Justice's prosecutions for insider trading—brought an indictment arising out of the same conduct alleging only wire fraud charges.[3] Unlike the SEC, the SDNY did not allege that any of the crypto assets at issue were securities, and did not charge securities fraud.

I. Background and Charges

The SEC and SDNY filed parallel civil and criminal actions against Ishan Wahi, a former manager at Coinbase, Inc. ("Coinbase"), Nikhil Wahi (Wahi's brother), and Sameer Ramani (Wahi's friend) based on allegations that Wahi tipped his brother and Ramani with material, nonpublic information concerning the timing and content of upcoming Coinbase "listing announcements."

As alleged, by virtue of his position as a manager, Wahi had access to confidential information regarding upcoming listings of crypto assets on the exchange. The SEC and SDNY allege that Wahi tipped information concerning these listing announcements to his brother Nikhil and friend Ramani allowing them to profit by purchasing the crypto assets in advance of the announcements, and subsequently selling the assets post-listing to the tune of over $1 million in total.

Both the SEC and SDNY actions allege and emphasize that Wahi's disclosure of listing information to his brother and Ramani violated the exchange's policies, which defined material nonpublic information to include asset listings, prohibited employees from disclosing such confidential information, and "expressly barred employees from providing a 'tip' to any person who might make a trading decision based on the information."[4]

1. SEC Charges

In a single-count complaint filed in the United States District Court for the Western District of Washington, the SEC contends that defendants' alleged insider trading scheme amounted to securities fraud in violation of Section 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R.§ 240.10b-5).

The SEC's complaint alleges that blockchain addresses linked to Nikhil Wahi and Ramani traded in at least 25 crypto assets ahead of more than 10 listing announcements. The SEC claims that 9 of the 25 crypto assets were securities. The SEC complaint does not explain why the remaining 16 crypto assets did not constitute securities. With respect to

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the nine crypto assets underlying the securities fraud charges, the SEC alleges that they were "investment contracts" under the securities laws because (a) they were "offered and sold to investors"; (b) "who made an investment of money in a common enterprise;" and (c) they created "a reasonable expectation of profits to be derived from the efforts of others."[5] The SEC further alleges that there were "continuing representations by issuers and their management teams regarding the investment value of the tokens, the managerial efforts that contribute to the tokens' value, and the availability of secondary markets for trading the tokens" such that "a reasonable investor in the nine crypto asset securities would continue to look to the efforts of the issuer and its promotors, including their future efforts, to increase the value of their investment."[6] The SEC case is before the Honorable Theresa L. Fricke in the Western District of Washington's Seattle Division.

2. SDNY Charges

The SDNY filed criminal charges against Wahi, Nikhil Wahi, and Ramani for the same conduct, but notably does not allege securities fraud. The SDNY indictment contains the following four wire fraud counts in violation of Title 18, United States Code, Section 1343: (1) conspiracy to commit wire fraud against Wahi and his brother; (2) a separate conspiracy to commit wire fraud against Wahi and his friend; (3) a substantive count of wire fraud against Wahi and his brother; and (4) a substantive count of wire fraud against Wahi and his friend.

The SDNY indictment alleges that, on the basis of tips from Ishan Wahi of material non-public information concerning anticipated listing announcements, Wahi's brother and friend separately executed trades concerning at least 25 different crypto assets shortly before at least 14 listing announcements, resulting in $1.5 million in illicit profits.[7]

In order to convict on the substantive wire fraud counts, the government must show: (1) a scheme or artifice to defraud; (2) money or property as the object of the scheme; and (3) the use of wires to further the scheme. To prevail on the conspiracy charges, the government must also show: (1) an agreement between Wahi and any alleged co-conspirator to execute the trading scheme; and (2) an overt act—whether innocent or illegal—committed in furtherance of the conspiracy. The SDNY case is before the Honorable Loretta Preska.

II. Notable Issues Arising from SEC Allegation that Certain Crypto Currencies Are Securities

The SEC's decision to pursue a securities fraud case against Wahi is noteworthy for a number of reasons.

First, the SEC's legal theory that certain crypto assets constitute "securities" is far from settled in the federal courts.[8] The SEC is in fact litigating a similar issue in an ongoing case against Ripple Labs concerning whether Ripple's sales of digital asset XRP constituted unregistered securities offerings.[9]

In this regard, it is notable that there is no securities fraud charge in the parallel criminal indictment. The SDNY only charged wire fraud and conspiracy to commit wire fraud—a highly atypical move in an insider trading case where the government almost always charges securities fraud. In a press release announcing four new insider trading indictments against nine individuals on July 25, 2022—all of which allege securities fraud—U.S. Attorney Damian Williams reinforced the SDNY's commitment to prosecuting insider trading and referenced the Wahi case in stating that insider trading is a form of "old school fraud" that may be committed using "new school methods." The lack of a securities fraud charge in the Wahi case potentially reflects the SDNY's concerns about proving beyond a reasonable doubt that defendants dealt in a "security" subject to the federal securities laws.

Significantly, a current Commissioner of the Commodity Futures Trading

Commission—which has brought actions in the crypto space related to crypto assets that are commodities—has also signaled discomfort with the SEC's action against Wahi. In an unusual rebuke, Commissioner Caroline D. Pham issued a public statement calling the SEC lawsuit a "striking example of regulation by enforcement."[10]

Second, any resolution indicating that the crypto assets at issue are securities is likely to lead to line drawing questions as to *which* crypto assets contain alleged hallmarks of traditional securities. The SEC itself publicly stated in 2018 that two digital assets (bitcoin and ether) were not securities.[11] And in 2020, SEC Commissioner Hester Peirce stated that a cryptocurrency may start out as a security digital asset and later become a non-security digital asset.[12]

Third, the SDNY and SEC parallel cases reflect an ongoing dedication of resources by the federal government toward investigating cases relating to crypto assets. Unquestionably, the United States Department of Justice, the SEC, and many other federal and state regulators have and will continue to focus on this area. Investigations which relate to crypto assets continue to draw significant resources for the foreseeable future.

Finally, the SEC's theory against Wahi merits monitoring by cryptocurrency market participants as they react to this evolving regulatory and enforcement landscape and consider their policies and procedures.

III. When Will the Court Decide in Wahi Whether These Crypto Assets Are Securities?

The timing of any court decision on the issue of whether these crypto assets are securities depends on a variety of important factors. First, it depends on whether Wahi and his co-defendants move to dismiss in the Western District of Washington. Second, it depends heavily on whether the SDNY moves to stay, and the extent of its motion to stay, the SEC's civil proceeding in the Western District of Washington. There is a history in the SDNY of moving for at least a partial stay in parallel SEC proceedings. Although the US DOJ and the SEC coordinate in terms of timing and share evidence when permissible in taking actions in their respective cases prior to charging, the SEC usually takes no position when the US DOJ seeks to stay any part of its civil proceeding. If the SEC's civil case is stayed in full pending the SDNY criminal case, there will be a long delay in any court hearing over whether the crypto assets in the SEC's case constitute securities. A typical criminal securities fraud case takes well over a year, and potentially far longer to reach its conclusion including any appeal. On the other hand, if the SEC's civil case is stayed in part, allowing the accused to seek to dismiss the charges on a legal basis, there might be a court decision and potential appeal relating to whether the crypto assets constitute securities in the near future.

IV. Conclusion

In sum, the SEC's complaint against Wahi fans the flames of a longstanding debate over whether crypto assets constitute securities, and the SEC's proper role in regulating crypto assets. While the SEC's actions reflect its interest in pressing the theory that such assets are securities under certain circumstances—without any guidelines yet—subject to its regulatory jurisdiction, it appears that federal district courts may provide the first initial guidance about the law.

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[1] *SEC v. Wahi*, No. 2:22-cv-01009 (W.D.Wash. Jul. 21, 2022) [hereinafter "SEC Complaint"].

[2] SEC Complaint ¶¶ 89-94.

[3] *United States v. Wahi*, No. 22-cr-392 (S.D.N.Y. Jul. 21, 2022) [hereinafter "SDNY

Complaint"].

[4] SDNY Complaint ¶ 7; *see also id*. ¶ 4.

[5] *Id*. ¶¶ 89-90; *see also id*. ¶¶ 103, 106, 114, 115, 125, 128, 138, 140, 149, 153, 163, 165, 172, 173, 186, 189, 200, 202.

[6] *Id*. ¶ 94.

[7] SDNY Complaint ¶ 3.

[8] *See, e.g., In re Tether & Bitfinex Crypto Asset Litig.*, No. 19-cv-9236 (KPF), 2021 WL 4452181, at *51 (S.D.N.Y. Sept. 28, 2021) (noting the unsettled nature of the security/commodity debate as it relates to crypto assets, and declining to classify a certain crypto asset as a "security, commodity, or some other type of good or asset"); *Barron v. Helbiz Inc.*, No. 20-cv-4703 (LLS), 2021 WL 229609, at *4 (S.D.N.Y. Jan. 22, 2021) (holding that Helbiz Coin, a type of crypto asset, is a security after engaging in a fact-intensive analysis of the product); *Sec. & Exch. Comm'n v. Blockvest, LLC*, No. 18-cv-2287 (GPB) (BLM), 2018 WL 6181408, at *1 (S.D. Cal. Nov. 27, 2018), *on reconsideration*, No. 18-cv-2287 (GPB) (BLM), 2019 WL 625163 (S.D. Cal. Feb. 14, 2019) (declining to determine whether the token that defendant had offered to investors was a "security" for the purposes of the federal securities laws before full discovery on the issue)

[9] *See SEC v. Ripple Labs Inc.*, No. 1:20-cv-10832 (S.D.N.Y. Dec. 22, 2020).

[10] Hansen, *supra* note 12.

[11] William Hinman, Dir., Div. of Corp. Fin., Sec. & Exch. Comm'n, Digital Assets Transactions: When Howey Met Gary (Plastic), (June 14, 2018), available at https://www.sec.gov/news/speech/speech-hinman-061418.

[12] Hester Peirce, Comm'nr, Sec. & Exch. Comm'n, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization (Feb. 6, 2020).

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