

# Regulatory and Enforcement Alert

## DOJ and SEC Charge First Ever Insider Trading of Crypto Assets

July 22, 2022

On July 21, 2022, the U.S. Attorney's Office for the Southern District of New York and the Securities and Exchange Commission announced parallel insider trading charges against three individuals for allegedly perpetrating a tipping scheme to trade multiple crypto assets ahead of public announcements that the assets would be listed (or made available to trade) on Coinbase, one of the largest crypto asset trading platforms in the U.S. This is the first time that insider trading charges related to crypto assets have been brought. U.S. Attorney Damian Williams said of the charges: "[f]raud is fraud is fraud, whether it occurs on the blockchain or on Wall Street. Web3 is not a law-free zone."

### Background

According to the SEC's complaint, typically the prices of crypto assets identified in Coinbase's public listing announcements would appreciate quickly and significantly following these announcements. As such, Coinbase's policies defined material nonpublic information ("MNPI") to include "information about a decision by Coinbase to list, not list, or add features to a Digital Asset [separately defined to include tokens]." The policies further prohibited Coinbase employees from disclosing MNPI to any other person, including family and friends, or tipping others who might make a trading decision using that MNPI.

One of the individuals charged, a (now-former) Coinbase product manager had first-hand knowledge through his role of which crypto assets Coinbase planned to make available for trading on its platform and when Coinbase planned to make listing announcements. The SEC alleges that, despite Coinbase's policies, this product manager tipped the other defendants (his brother and a close friend) in advance of multiple listing announcements. Based on these tips, the other defendants allegedly purchased at least 25 crypto assets, at least nine of which were alleged to be securities, and typically sold them for a profit shortly after the listing announcements. The SEC's complaint alleges that the nearly year-long insider trading scheme generated more than \$1.1 million in illegal profits. Commenting on the charges, and consistent with the SEC's efforts to aggressively police the crypto markets, Gurbir S. Grewal, Director of the SEC's Division of Enforcement, said "We are not concerned with labels, but rather the economic realities of an offering. In this case, those realities affirm that a number of the crypto assets at issue were securities, and, as alleged, the defendants engaged in typical insider trading ahead of their listing on Coinbase."

## Key Takeaways From the Charges

**SEC Takes the Position That Some of the Tokens Were Securities.** The SEC did not allege that all of the crypto assets at issue in the case were securities, instead taking the position that some were securities under *SEC v. Howey Co.*, 328 U.S. 293 (1946) for purposes of the Rule 10b-5 charges. The complaint explained that “[a] digital token or crypto asset is a crypto asset security if it meets the definition of a security, which the Securities Act defines to include ‘investment contract,’ *i.e.*, if it constitutes an investment of money, in a common enterprise, with a reasonable expectation of profit derived from the efforts of others.” The SEC’s characterizations of certain assets as securities, however, are merely allegations and must be proven in the course of discovery and litigation. In a notable public reaction to the SEC’s action, Commissioner Caroline D. Pham of the Commodity Futures Trading Commission stated that the charges are a “striking example of ‘regulation by enforcement.’”

**DOJ and SEC Pursue Different Charges.** Notably, the DOJ and SEC did not bring the same charges. The SEC, as they must, alleged that defendants violated the securities laws—thus necessitating the allegations that certain of the assets were securities—while the DOJ charged the defendants with wire fraud and wire fraud conspiracy. The DOJ’s case therefore appears to be based on a straightforward theft of Coinbase’s information. By pursuing only wire fraud charges alone, DOJ avoids the burden of establishing that certain of the assets were securities. Notably, DOJ took a similar approach last month when it brought wire fraud and money laundering charges against a former product manager related to a scheme to commit insider trading in NFTs (non-fungible tokens) by using confidential information about which NFTs would be featured on the homepage of an NFT marketplace. The SEC did not bring parallel charges in that action.

Although it is too early to determine whether the DOJ will move to stay the SEC’s parallel civil case, it would be customary for it to do so. In most parallel SEC and DOJ cases in which the SEC case is stayed pending completion of the criminal case, the DOJ’s victory in the criminal case effectively moots the civil case, given the overlap in factual allegations and lesser civil standard of proof.

Here, however, if the SEC’s case is stayed during the pendency of the criminal case and the criminal case is successful, it will raise the somewhat unusual scenario of a criminal conviction leaving unaddressed a core legal issue in a parallel SEC case, namely whether certain digital assets are in fact securities.

**Blockchain Anonymity Poses No Obstacle.** The DOJ and SEC charges are also a clear sign that government investigators are actively tracing assets through blockchain. While it appears that the two purchasing defendants sought to conceal their purchases using multiple anonymous Ethereum blockchain wallets, both the SEC and DOJ indicated that they linked the wallets to the defendants through IP address records and blockchain analysis.

**Crypto Policing Efforts Ramping Up.** These charges follow the February 2022 announcement by U.S. Deputy Attorney General Lisa Monaco of the launch of a new cryptocurrency task force within the Federal Bureau of Investigation, which was only four months after the DOJ launched its own National Cryptocurrency Enforcement Team. Indeed the U.S. Attorney acknowledged the assistance of the DOJ’s National Cryptocurrency Enforcement

Team in announcing the criminal charges. The charges appear to further underscore the federal government's intense interest in policing perceived abuses in the crypto space.

CONTACT THE AUTHORS

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For further information about this Alert, please contact the following authors: Martin S. Bell, Marc P. Berger, Nicholas S. Goldin, Joshua A. Levine, Michael J. Osnato, Jr., or any other member of the **Government and Internal Investigations** group below.

GOVERNMENT AND INTERNAL INVESTIGATIONS GROUP

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**Antonio Bavasso**  
+44-(0)20-7275-6122  
[antonio.bavasso@stblaw.com](mailto:antonio.bavasso@stblaw.com)

**Martin S. Bell**  
+1-212-455-2542  
[martin.bell@stblaw.com](mailto:martin.bell@stblaw.com)

**Marc P. Berger**  
+1-212-455-2197  
[marc.berger@stblaw.com](mailto:marc.berger@stblaw.com)

**Stephen P. Blake**  
+1-650-251-5153  
[sblake@stblaw.com](mailto:sblake@stblaw.com)

**Stephen M. Cutler**  
+1-212-455-2773  
[stephen.cutler@stblaw.com](mailto:stephen.cutler@stblaw.com)

**Adam Goldberg**  
+852-2514-7552  
[adam.goldberg@stblaw.com](mailto:adam.goldberg@stblaw.com)

**Nicholas S. Goldin**  
+1-212-455-3685  
[ngoldin@stblaw.com](mailto:ngoldin@stblaw.com)

**Meaghan A. Kelly**  
+1-202-636-5542  
[mkelly@stblaw.com](mailto:mkelly@stblaw.com)

**Jeffrey H. Knox**  
+1-202-636-5532  
[jeffrey.knox@stblaw.com](mailto:jeffrey.knox@stblaw.com)

**James G. Kreissman**  
+1-650-251-5080  
[jkreissman@stblaw.com](mailto:jkreissman@stblaw.com)

**Noritaka Kumamoto**  
+81-3-5562-6219  
[nkumamoto@stblaw.com](mailto:nkumamoto@stblaw.com)

**Joshua A. Levine**  
+1-212-455-7694  
[jlevine@stblaw.com](mailto:jlevine@stblaw.com)

**Michael J. Osnato, Jr.**  
+1-212-455-3252  
[michael.osnato@stblaw.com](mailto:michael.osnato@stblaw.com)

**Karen Porter**  
+1-202-636-5539  
[karen.porter@stblaw.com](mailto:karen.porter@stblaw.com)

**Cheryl J. Scarboro**  
+1-202-636-5529  
[cscarboro@stblaw.com](mailto:cscarboro@stblaw.com)

**John Terzaken**  
+1-202-636-5858  
[john.terzaken@stblaw.com](mailto:john.terzaken@stblaw.com)

**Jonathan K. Youngwood**  
+1-212-455-3539  
[jyoungwood@stblaw.com](mailto:jyoungwood@stblaw.com)

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