

INSIDER TRADING & DISCLOSURE UPDATE

SEC and DOJ Bring Inaugural Digital Asset Insider Trading Tipping Cases to Successful Conclusions

As we wrote in our September 2022 [Update](#), on July 21, 2022 the SEC and DOJ announced parallel actions against Ishan Wahi, a former product manager at Coinbase—one of the largest cryptocurrency exchanges in the world—along with his brother, Nikhil Wahi, and a friend for engaging in an insider trading scheme.

SEC Settlement with Wahi Brothers

On May 30, 2023, the SEC announced that Ishan Wahi and his brother, Nikhil Wahi, agreed to settle the insider trading charges the SEC brought against both men.¹ The SEC alleged that the Wahi brothers engaged in insider trading through a scheme to trade at least nine digital assets that the SEC alleged were securities ahead of Coinbase listing announcements about the subject assets.

According to the SEC's complaint, Ishan Wahi was involved in the confidential process of listing new digital assets on Coinbase platforms and had knowledge of which digital assets Coinbase was planning to list, along with the timing of the related public listing announcements. The market value of assets typically significantly increased after a Coinbase listing announcement. From at least June 2021 to April 2022, Ishan Wahi allegedly used this access to confidential information to tip his brother, Nikhil Wahi, or his friend, Sameer Ramani, about the timing of listings so that they could acquire digital assets shortly before the public listing announcement and sell the assets after listing.² Nikhil Wahi and Ramani allegedly purchased at least 25 crypto assets, at least nine of which the SEC alleged were securities, and then typically sold them at a profit shortly after the public announcements. According to the SEC, this scheme generated illicit profits totaling at least \$1.1 million.³

As part of the settlement, the Wahi brothers agreed not to deny the SEC's allegations. They also each agreed to be permanently enjoined from violating Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act") and to pay disgorgement of ill-gotten gains, plus prejudgment interest.⁴ Subject to court approval, the disgorgement and prejudgment interest would be deemed satisfied by the orders of forfeiture of the Wahi brothers' assets in the parallel criminal action brought by the U.S. Department of Justice (the "DOJ"), and the SEC determined not to seek civil penalties.⁵

DOJ Wins Guilty Plea in Parallel Case against the Wahi Brothers

On February 7, 2023, the DOJ announced that Ishan and Nikhil Wahi pled guilty to conspiracy to commit wire fraud.⁶ The DOJ's indictment was brought under the federal wire fraud statute, 18 U.S.C. § 1343, rather than the more traditional Exchange Act insider trading provisions. This charging decision, as in the *Chastain* case described below, was likely made to avoid the need to litigate whether the digital assets at issue constitute securities under federal securities laws. Ishan Wahi was sentenced to 24 months in prison and ordered to forfeit 10.97 ether and 9,440 tether, and Nikhil Wahi was sentenced to 10 months in prison and ordered to forfeit \$892,500.⁷

SEC Applies Classical Insider Trading Laws to Crypto Assets

Unlike the DOJ's prosecution, the SEC's pursuit of securities fraud charges—pursuant to Section 10(b) of the Exchange Act—presuppose that the underlying asset is a security. The SEC thus was required to, and did, take the position that certain digital assets traded as part of the scheme in *Wahi* were securities. In particular, the SEC's complaint alleged that Wahi and his co-defendants traded in at least 25 digital assets, "at least nine" of which involved securities, and in doing so stated 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."⁸

In a statement announcing the settlement, Gurbir S. Grewal, Director of the SEC's Division of Enforcement, emphasized that "[w]hile the technologies at issue in this case may be new, the conduct is not. We allege that Ishan and Nikhil Wahi, respectively, tipped and traded securities based on material nonpublic information, and that's insider trading, pure and simple," and warned that "[t]he federal securities laws do not exempt crypto asset securities from the prohibition against insider trading, nor does the SEC."⁹

Takeaway

The SEC's action against the Wahi brothers was just one example of the government's recently intensified focus on crypto-related enforcement actions. In particular, the SEC has been quite active in its enforcement activity related to digital assets and tokens that the SEC alleges are securities under the test set forth in *SEC v. W.J. Howey Co.*¹⁰ In light of the *Wahi* settlement, the SEC's position regarding the application of classical insider trading laws to digital

assets remains largely untested, but the SEC's intent to pursue such cases in the future is clear.

While the SEC must grapple with *Howey*, and whether the assets being traded are securities for purposes of seeking enforcement under insider trading laws, the DOJ demonstrated a blueprint for avoiding this potential hurdle to a successful prosecution in *Chastain*.

DOJ Wins Conviction in Inaugural Digital Asset Insider Trading Case

On May 3, 2023, Nathaniel Chastain was convicted by a federal jury of wire fraud and money laundering charges in a case involving the federal government's first indictment for insider trading of a digital asset. As discussed in our September 2022 [Update](#), Chastain—a former products manager at the non-fungible tokens ("NFT") and crypto collectibles marketplace OpenSea—was alleged to have "misappropriated OpenSea's confidential business information about what NFTs were going to be featured on its homepage" by using the information to purchase several NFTs before they were featured and trading them for profit.¹¹ Chastain's conviction, following a week-long trial, is a significant win for the federal government, because it: (1) solidifies the path for the DOJ to pursue digital asset insider trading charges without the need to prove that the underlying digital assets are securities; and (2) provides additional color—mostly to the government's advantage—about confidential business information as "property" in light of *Kelly v. United States*¹² and its progeny.

Court Confirms Wire Fraud Statute Does Not Require Showing That NFTs Are Securities

Although the alleged scheme consisted of conduct more typically considered to be insider trading, the government brought charges against Chastain under the federal wire fraud statute, 18 U.S.C. § 1343, rather

than the Exchange Act pursuant to 15 U.S.C. § 78j and 17 C.F.R. § 240.10b-5. As a result, the government was required to prove—beyond a reasonable doubt—that Chastain effected a “scheme or artifice to defraud or for obtaining money or property by means of false or fraudulent pretenses, representations or promises.”¹³ Importantly, by charging Chastain under the wire fraud statute, the government did not need to show that the scheme involved trading in securities. In rejecting Chastain’s pre-trial motion to dismiss the indictment, the Court emphasized that § 1343 “makes no reference to securities or commodities” and that requiring a showing of trading in securities or commodities transactions “would be to read an additional element into the wire fraud statute, which the Court may not do.”¹⁴ Therefore, the government could sidestep the hotly debated question of whether NFTs—and digital assets broadly—are securities.

Meaning of “Property”

On the other hand, charging Chastain under the wire fraud statute meant that the government had to overcome a different hurdle: proving that Chastain misappropriated *property* within the meaning of § 1343. As discussed in our May 2023 [Update](#), the Supreme Court limited the scope of “property” in its consequential 2020 decision in *Kelly*, otherwise known as the “Bridgegate” case, in which the Court emphasized that the wire fraud statute is “limited in scope to the protection of property rights” and that the object of the fraud must be money or property.¹⁵ The Court rejected the government’s argument that depriving the Port Authority of the use of traffic lanes leading to the George Washington Bridge during rush hour was a taking of “property” under the wire fraud statute and held that a mere interference in the Port Authority’s intangible rights of “allocation, exclusion, and control” in its regulatory affairs does not create a “property interest.”¹⁶

The bounds of property under § 1343 were tested again more recently in *United States v. Blaszczyk*,¹⁷ in

which the defendants came before the Second Circuit on remand after successfully petitioning the Supreme Court for a *writ of certiorari* following *Kelly*. As we described in our previous [Update](#), *Blaszczyk* involved a former employee of the Centers for Medicare & Medicaid Services (“CMS”) allegedly providing confidential information to an employee of a private political intelligence firm about CMS’s reimbursement-rate decisions before the agency released its decisions to the public, who then provided the information to several hedge funds. In a 2-1 decision, the Second Circuit embraced the view that the information about pending CMS regulations and the timing of relevant disclosures are “regulatory in nature” and do not constitute property of the CMS.¹⁸ In doing so, the majority followed *Kelly*’s conclusion that “a scheme to alter . . . a regulatory choice is not one to appropriate the government’s *property*” and decided that the CMS information did not involve any greater property interest.¹⁹

The government’s theory in *Chastain* was that OpenSea’s confidential business information—about which NFTs to feature on its website—was property belonging to OpenSea under § 1343. Though both *Kelly* and *Blaszczyk* involved a government agency’s confidential information, and not that of a private enterprise, the restrictive posture of the courts in both decisions appeared to signal that using wire fraud as a means of charging insider trading may not be a straightforward endeavor. In pre-trial proceedings, Chastain argued that, to qualify as property, the confidential business information “must have some ‘inherent economic value’ to its owner.”²⁰ In doing so, Chastain relied partly on *Blaszczyk*, which made reference to “inherently valuable” government information in deciding whether the CMS information described above was property.²¹ However, Judge Jesse M. Furman rejected Chastain’s argument. After explaining that confidential business information—even though intangible—may qualify as “property” under § 1343, the court held that it is not necessary to prove that information had “inherent value.”²² Instead, the court pointed to two requirements to

establish such information as property: (1) that the information be “acquired or compiled by [an employer] in the course and conduct of its business”;²³ and (2) that the information be “both considered and treated by an employer in a way that maintained the employer’s exclusive right to the information[.]”²⁴ Responding to Chastain’s reference to *Blaszczak*, the court distinguished *Blaszczak*’s use of “inherently valuable” as relevant only to explain why the CMS information was “regulatory in character” and emphasized that *Blaszczak* did not deal with *business* information at all.²⁵ As a result, it appears likely that confidential business information will constitute property in most cases, whereas confidential government information may not.

Chastain’s Trial

The nature of the information Chastain obtained about NFTs OpenSea planned to feature was thus a pivotal part of the trial. One of the key points of contention was whether an employee confidentiality agreement signed by Chastain—along with other OpenSea workers—prohibited Chastain’s conduct. If it did, Chastain misappropriated “confidential” business information—i.e., the “property” through which the government was able to bring charges under the wire fraud statute.²⁶ The jury heard testimony from OpenSea’s co-founders Devin Finzer and Alex Atallah, who both thought that the agreement banned Chastain’s conduct, but Finzer also told the jury that he hadn’t “thought closely about whether [the information about featured NFTs] was confidential information[.]”²⁷ The lack of clarity about confidentiality appears to have played a role in the jury’s decision, with one juror remarking that Finzer’s testimony was a point of contention.²⁸ Chastain also pointed to evidence that, after he resigned from OpenSea, the company updated its policies to prohibit employees from conducting trades similar to that of Chastain. Chastain argued that this change illustrated that, while he was employed at OpenSea, there was no company policy specifically barring his conduct.²⁹ In

response, the prosecution pointed to Slack messages by Chastain describing his “FOMO” when he did not buy the featured NFTs, arguing that Chastain knew he could not use the information for himself.³⁰ The government also explained how Chastain transferred cryptocurrency to anonymous accounts to make the purchases in question, a practice he did not follow when buying other NFTs. In the end, Chastain could not sway the jury’s decision in his favor. The jury convicted him of wire fraud and money laundering counts after three days of deliberation. Chastain is scheduled to be sentenced on August 22, 2023.

Takeaway

Chastain’s conviction is a cautionary tale for the defense bar because it shows that the government can successfully prosecute insider trading schemes involving digital assets as wire fraud without having to establish that the underlying digital assets are securities. The district court’s pre-trial decision also confirms that confidential business information is a well-established form of property under § 1343, clearly distinguishing it from the types of government information at issue in *Kelly* and *Blaszczak*.

For additional information on crypto-related enforcement actions, please see our Debevoise FinReg and FinTech Blog [here](#).

Notes

- ¹ SEC Press Release No. 2023-98, *Former Coinbase Manager and His Brother Agree to Settle Insider Trading Charges Relating to Crypto Asset Securities* (May 30, 2023), <https://www.sec.gov/news/press-release/2023-98> [hereinafter “Wahi Settlement Press Release”].
- ² SEC Press Release No. 2022-127, *SEC Charges Former Coinbase Manager, Two Others in Crypto Asset Insider Trading Action* (July 21, 2022), <https://www.sec.gov/news/press-release/2022-127>.
- ³ *Id.*
- ⁴ See Wahi Settlement Press Release.
- ⁵ *Id.*
- ⁶ DOJ Press Release No. 23-040, *Former Coinbase Insider Pleads Guilty In First-Ever Cryptocurrency Insider Trading Case* (Feb. 7, 2023), <https://www.justice.gov/usao-sdny/pr/former-coinbase-insider-pleads-guilty-first-ever-cryptocurrencyinsider-trading-case>.
- ⁷ See Wahi Settlement Press Release.
- ⁸ See Compl. at ¶¶ 7, 24, 89–94, *SEC v. Ishan Wahi et al.*, 22-cv-01009 (W.D. Wash. 2022).
- ⁹ See Wahi Settlement Press Release.
- ¹⁰ 328 U.S. 293 (1946).
- ¹¹ See Indictment at ¶¶ 1, 3, *United States v. Chastain*, 22-cr-305 (2022), <https://www.justice.gov/usao-sdny/pressrelease/file/1509701/download>.
- ¹² 140 S. Ct. 1565 (2020).
- ¹³ 18 U.S.C. § 1343 (emphasis added).
- ¹⁴ *United States v. Chastain*, No. 22-CR-00305, 2022 WL 13833637, at *2 (S.D.N.Y. Oct. 21, 2022).
- ¹⁵ 140 S. Ct. 1565, 1566 (*citing* *McNally v. United States*, 483 U.S. 350, 360 (1987)).
- ¹⁶ *Id.* at 1572.
- ¹⁷ 56 F.4th 230, 236 (2d Cir. 2022).
- ¹⁸ *Id.* at 244.
- ¹⁹ *Id.* at 243 (emphasis in original).
- ²⁰ *United States v. Chastain*, No. 22-CR-00305, 2023 WL 2966643, at *1 (S.D.N.Y. Apr. 17, 2023).
- ²¹ *Blaszczak*, 56 F.4th at 244.
- ²² *Chastain*, 2023 WL 2966643 at *1, 4.
- ²³ *Id.* at *3 (*citing* *Carpenter v. United States*, 484 U.S. 19 (1987)).
- ²⁴ *Id.* at *3 (*citing* *United States v. Mahaffy*, 693 F.3d 113 (2d Cir. 2012)).
- ²⁵ *Id.* at *4.
- ²⁶ Pete Brush, *Former OpenSea Manager Convicted in NFT Homepage Fraud Case*, Law360 (May 3, 2023), <https://www.law360.com/fintech/articles/1602380>.
- ²⁷ *Id.*
- ²⁸ *Id.*
- ²⁹ *Id.*
- ³⁰ Jane Wester, *Former NFT Marketplace Employee Found Guilty of Wire Fraud, Money Laundering*, N.Y.L.J. (May 3, 2023), <https://www.law.com/newyorklawjournal/2023/05/03/former-nft-marketplace-employee-found-guilty-of-wire-fraud-money-laundering/?sreturn=20230512232053>.

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