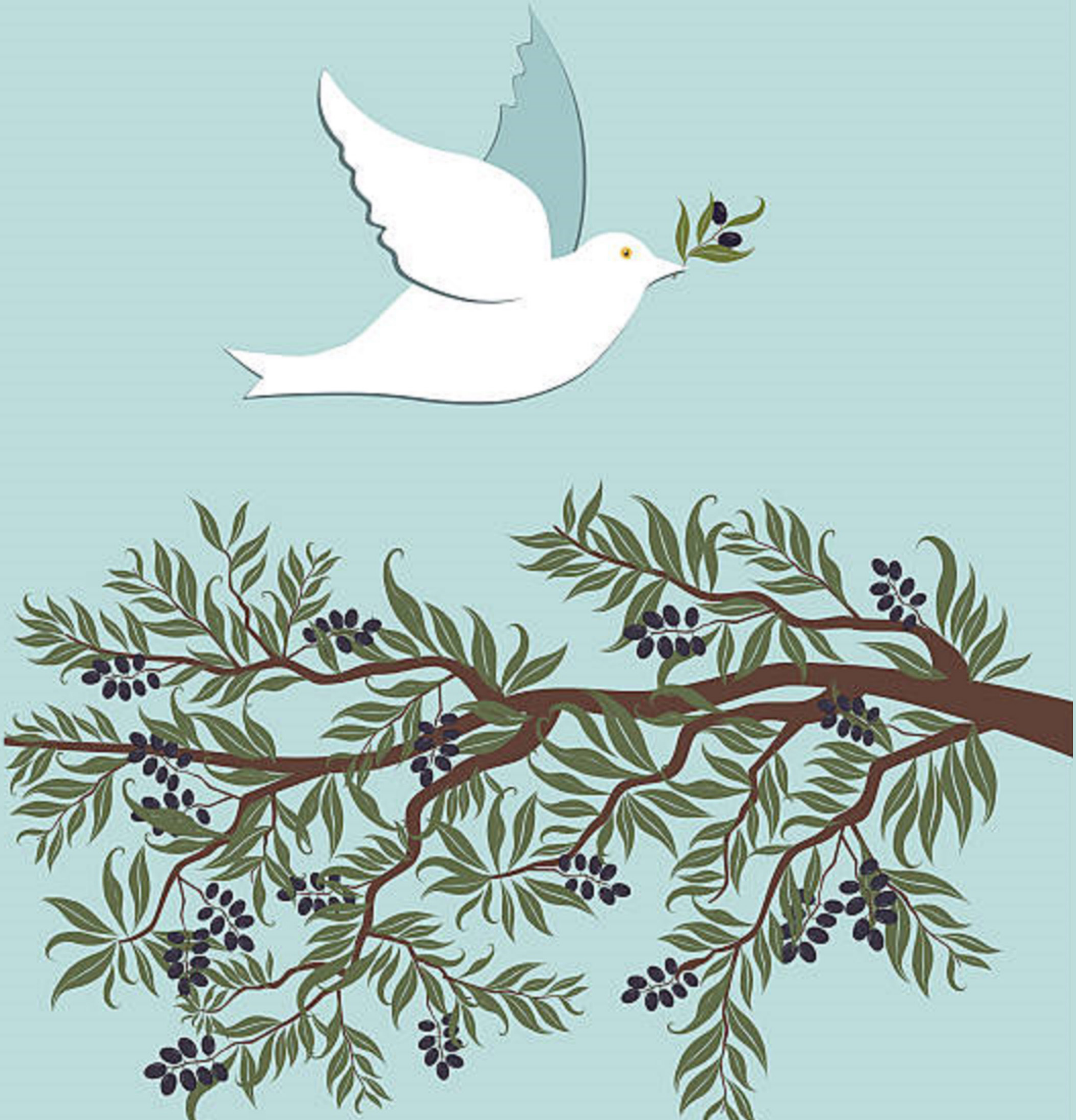
THE DECALOGUE TABLETS



SPRING 2024

Genius Gone Awry: The Sam Bankman-Fried Trial

by John J. Miceli and Howard Rosenburg

The rise and fall of Sam Bankman-Fried is a cautionary tale of ambition and greed.

The son of two Stanford Law School professors, Bankman-Fried graduated from MIT in 2014, with a physics major and a mathematics minor. In 2017 he left the proprietary trading firm he was working at and co-founded the quantitative trading firm Alameda Research. Two years later he founded FTX, a cryptocurrency derivatives exchange that eventually became headquartered in the Bahamas.

Bankman-Fried grew FTX into one of the leading exchanges for buying and selling cryptocurrency derivatives and, in early 2022, investors valued FTX and its U.S. operations at a combined $40 billion. At the peak, Bankman-Fried's estimated wealth totaled $26.5 billion. People were fascinated by this young billionaire genius who wore his hair long and messy and dressed in stretched out t-shirts and cargo shorts. Yet, like so many others before him, Bankman-Fried's world came crashing down.

What Happened?

FTX collapsed over the course of just ten days. On November 2, 2022, cryptocurrency news site CoinDesk reported that the majority of Almeda Research's assets were comprised of cryptocurrency tokens that were invented and controlled by FTX. Four days later, Binance, a FTX rival exchange, sold the FTX-invented tokens that it held and FTX's customers began to withdraw their funds from FTX.

The next day, FTX announced a liquidity crisis and sought a bailout from venture capital firms including, ironically, its rival Binance. On November 9, Binance, after conducting due diligence, walked away from discussions about acquiring FTX's non-U.S. business.

The following day, the Bahamas froze FTX's assets and Bankman-Fried admitted that FTX's non-U.S. businesses faced a liquidity crisis. He also announced that he would wind down Alameda Research. Capping it off, on November 11, FTX filed for Chapter 11 bankruptcy protection and Bankman-Fried stepped down as CEO.

On December 12, Bankman-Fried, who had been living with some coworkers in a $35 million penthouse in the Bahamas, was arrested and jailed there before being extradited to the United States. The next day, the U.S. Department of Justice unsealed an indictment with eight criminal counts including wire and securities fraud, money laundering, unlawful campaign finance contributions. The SEC and CFTC also brought enforcement actions for civil claims of securities and commodities fraud.

The government called this "one of the biggest financial frauds in American history." Three of Bankman-Fried's top associates pleaded guilty to fraud and agreed to cooperate with prosecutors. Among those who testified were Gary Wang, an FTX co-founder, Nishad Sing, a top FTX executive, and Caroline Ellison, the Alameda Research chief executive who was also Bankman-Fried's former girlfriend.

Wang testified that Bankman-Fried instructed him to create a secret back door in the exchange's code that allowed Alameda Research to borrow a virtually limitless amount of customer funds. Sing testified that billions in FTX customer funds had gone missing. And Ellison testified that she conspired with Bankman-Fried to mislead the public and doctor up balance sheets she sent to lenders.

After a monthlong trial, a Southern District of New York jury convicted Bankman-Fried of seven charges of fraud and conspiracy. The trial exposed the house of cards Bankman-Fried constructed. In the end, it took little over twenty-four hours of deliberation for the jury to reach its verdict. The verdict closed one of the most spectacular and captivating falls from grace in modern history. Once heralded as a modern J.P. Morgan, Bankman-Fried now faces up to 110 years in prison. His sentencing is scheduled for late March.

Behind the splashy headlines though are a number of intriguing issues, each of which merit significant consideration.

1. Social media doomed Bankman-Fried's testimony.

If it wasn't dangerous enough to provide post-indictment interviews to the press, Bankman-Fried took the rare step of testifying in his own defense. Exposing a criminal defendant to cross examination is a highly risky strategy, and no doubt his defense team gave it careful consideration before allowing it.

The risk did not pay off. Bankman-Fried tried to convey that while he made mistakes, he relentlessly sought to make FTX successful and never engaged in anything criminal. However, over the course of his testimony, the government effectively used social media and other electronic communications to attack him. While on the stand, Bankman-Fried said "I do not recall" more than one hundred times. Over and over again, the prosecutor quickly presented him with his own tweets, pictures, texts, and other electronic communications. The quick repetition of this cycle during the course of cross-examination undermined and demoralized Bankman-Fried. It showed in both his oral responses and his body language. Slumped in his chair and irritated with the cross examination, he resorted to giving rambling responses to questions, prompting the judge to admonish him repeatedly. This undoubtedly left an overwhelmingly negative impression on the jury.

2. FTX Bankruptcy Proceedings.

The FTX recovery and restructuring efforts are proving to be a long and difficult process. As of April 2023, FTX received $7.3 billion in cash and liquid cryptocurrency assets, marking a significant milestone in its efforts to address the fallout from its collapse.

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In proceedings before a Delaware court, FTX submitted plans that outline its strategy for restructuring. However, the complexities of creditor negotiations and asset distribution mean that a Chapter 11 plan isn't expected to be approved before the second quarter of 2024.

The bankruptcy has also presented the issue of when to value the cryptocurrency assets frozen in bankruptcy. The value of many cryptocurrencies has increased significantly since the FTX bankruptcy filing. Many FTX customers have complained about the company's decision to value the digital assets on the November 2022 bankruptcy petition date, arguing it is unfair because they would miss out on the recent price recovery. However, Judge John Dorsey, who presides over the FTX bankruptcy case, said that the bankruptcy code is "very clear" and that a claim is to be determined in U.S. dollars as of the petition date.

Additionally, since filing for bankruptcy in November 2022, FTX has filed several lawsuits in an attempt to claw back other funds it claims it is owed. In September 2023, FTX said it had identified $16.6 billion in potential actions.

The company faces over 36,000 claims from customers that total over $16 billion. FTX has said customers would get as much as 90% of whatever is recovered during the bankruptcy. It is yet to be seen what that ultimate recovery will be.

3. No Second Trial on Campaign Contribution and Other Charges.
In December 2023, prosecutors told the U.S. District Court that a second trial of Bankman-Fried was not necessary. The second trial would have included the additional charges that were brought against Bankman-Fried but were withdrawn because they had not been approved as part of Bankman-Fried's extradition from the Bahamas in December 2022. The dropped charges included conspiracy to make unlawful campaign contributions, conspiracy to bribe foreign officials and two other conspiracy counts.

Authorities have said the Bankman-Fried and others at FTX made $90 million in campaign contributions to about three hundred political candidates or political action committees using customer deposits. However, after FTX's collapse, prosecutors and bankruptcy lawyers for FTX asked for the return of the donations from recipients.

According to prosecutors, a second trial would duplicate evidence already shown to a jury and would ignore the "strong public interest in a prompt resolution" of the case. Importantly, prosecutors noted that the victims would not benefit from the second trial if sentencing was delayed. One could wonder how the case outcome would differ if the campaign contribution and bribery allegations were included.

4. Bankman-Fried's parents face potential liability.
The fallout from the FTX collapse also has resulted in lawsuits being filed against Bankman-Fried's parents. According to a lawsuit filed in September 2023, Bankman-Fried's father allegedly received a $10 million gift in early 2022 from funds originating from Alameda Research. The lawsuit also alleges that Bankman-Fried helped his parents obtain a $16 million luxury property in the Bahamas with FTX money. According to the lawsuit, Bankman-Fried's parents "exploited their access and influence within the FTX enterprise to enrich themselves." His parents have responded, asserting that the claims are false. If this case proceeds to trial, many of the same matters will be at issue, albeit in the civil context.

5. Regulators step in.
Since the Bankman-Fried trial regulatory bodies worldwide have been reassessing the regulatory framework surrounding cryptocurrencies and digital assets. They see the FTX collapse as underscoring the necessity for clearer regulations, improved transparency, and enhanced consumer protections in the crypto industry.

Criminal and civil enforcement actions have also followed. In June 2023, the SEC sued Binance and Coinbase alleging that they operated as securities exchanges without properly registering their business with the SEC.

In November 2023, United States Department of Justice announced that Binance CEO Changpeng Zhao ("CZ") would plead guilty to felony charges and also announced a $4.3 billion settlement with Binance and CZ to cover "civil regulatory enforcement actions" by government departments including the U.S. Treasury and CFTC. As part of the action, the Department of Justice stated that Binance's policies allowed criminals involved in illicit activities to move "stolen funds" through the exchange. The DOJ said that the exchange "pretended to comply" with U.S. laws by offering paths for certain users to access Binance despite ties to illicit funds. It also said that Binance would be subject to monitoring and reporting requirements and be required to file suspicious activity reports for past transactions. While the settlement resolved many of the civil and criminal investigations into Binance, the SEC's civil case remains pending.

Conclusion
In 2021, Forbes listed Bankman-Fried in its "30 Under 30" list. Two years later, it listed him in its "Hall of Shame" list. The story of Sam Bankman-Fried, from his meteoric rise to his dramatic fall, encapsulates the volatile nature of the cryptocurrency market itself. As the cryptocurrency industry continues to evolve, the lessons learned from the rise and fall of FTX and its founder will undoubtedly shape its regulatory and operational landscape for years to come.

John J. Miceli and Howard Rosenburg are attorneys at Kopecky Schumacher Rosenburg LLC, a boutique law firm handling business and securities litigation.