

CFTC ALLEGES MANIPULATIVE TRADING ON A DECENTRALIZED DIGITAL ASSET PLATFORM

*By Neal E. Kumar, Paul J. Pantano, Jr., J. Christopher Giancarlo, Kari S. Larsen, Michael Selig, Michael Hartz, and Matthew Goldberg**

On January 9, 2023, the Commodity Futures Trading Commission (“CFTC”) filed its first-ever action for a fraudulent or manipulative scheme involving trading on a decentralized digital asset exchange. The CFTC brought the complaint against Avraham Eisenberg (“Defendant”), who allegedly used fraudulent and manipulative conduct to obtain more than \$100 million worth of digital assets from an exchange called Mango Markets.¹ The Securities and Exchange Commission (“SEC”) also brought a civil enforcement action against the Defendant.² In a parallel criminal action that commenced December 2022, the Department of Justice (“DOJ”) charged the Defendant with commodities fraud and manipulation.³ Prior to the filing of the CFTC Complaint, the Defendant was arrested in Puerto Rico.⁴

*Neal E. Kumar and Kari S. Larsen are partners; J. Christopher Giancarlo and Paul J. Pantano, Jr., are senior counsel; Michael Selig is counsel; and Michael Hartz and Matthew Goldberg are associates at Wilkie Farr & Gallagher LLP.

The CFTC and SEC matters have been stayed pending resolution of the DOJ’s criminal case.⁵ The DOJ, CFTC, and SEC actions serve as reminders that, despite the lack of a comprehensive regulatory framework for digital assets, the DOJ, CFTC, and SEC all may have the authority to pursue manipulative schemes involving digital asset commodities, depending upon the circumstances.

This case presents a new buzzword in CFTC digital asset cases—“oracle manipulation.” Decentralized exchanges and decentralized lending platforms often-times use an oracle to source data regarding the current price of a digital asset. The pricing data from the oracle is then used to price digital assets on the decentralized exchange. Oracle manipulation refers to the concept of trading to manipulate the price of a digital asset such that an oracle utilizes the artificial price on the decentralized exchange, thereby enabling a trader to establish positions on the decentralized exchange that benefit from the artificial price.

In addition, this matter continues to showcase the jurisdictional divide between digital assets that are commodities versus securities. The CFTC has anti-fraud and anti-manipulation authority for

digital assets that are commodities under the Commodity Exchange Act (“CEA”) whereas the SEC regulates digital assets that are securities. For the first time, the CFTC will argue in court that a stablecoin, in this case USDC, is a commodity. Although the CFTC previously took the position that a different stablecoin, USD Tether (“USDT”), is a commodity under the CEA, this prior matter was a negotiated settlement with Tether.⁶ The CFTC Complaint may also imply that an illiquid governance token, in this case MNGO, is a commodity. That said, the SEC’s action against the Defendant asserts that MNGO is a security, so market participants should continue to monitor developments in these cases due to the far-reaching regulatory implications of digital assets being deemed commodities or securities.⁷

Lastly, the case serves as another reminder about the perils of social media and trading. The Defendant tweeted about his ongoing activity and sent messages in group chats that the CFTC now relies upon as evidence of the manipulative scheme.

BACKGROUND

Mango Markets operated a decentralized digital asset exchange (“DEX”), which utilized the Solana blockchain to facilitate direct, peer-to-peer digital asset transactions without an intermediary. Mango Markets offered its users spot and margined trading of virtual currencies, such as bitcoin and ether.⁸ In addition, Mango Markets allowed trading of “USDC,” a stablecoin intended to be redeemable on a 1:1 basis with the U.S. Dollar. Mango Markets also had its own governance token called MNGO that market participants could trade. Each of these digital assets was also traded on other exchanges.⁹

Mango Markets also offered a “borrowing and lending” function that allowed users to deposit certain digital assets as collateral and to withdraw other digital assets up to a certain amount, depending on the value of the collateral and the value of the borrower’s portfolio on Mango Markets.¹⁰

Additionally, Mango Markets offered products referred to as “perpetual contracts” or “perpetual futures,” which were valued based on the relative value of two digital assets—for example, between MNGO and USDC. According to the CFTC Complaint, certain digital assets involved in this matter are commodities under the CEA, including bitcoin, ether, and USDC.¹¹ Although the CFTC did not expressly plead that the MNGO governance token is a commodity, the CFTC did plead that MNGO-USDC perpetual contracts are swaps under the CEA subject to the CFTC’s jurisdiction. This could imply that the CFTC views MNGO as a commodity and not a security because the SEC, not the CFTC, has jurisdiction to regulate security-based swaps.

In order to calculate the market value of contracts traded through the DEX, Mango Markets used a program called an oracle to pull market price data from three other exchanges (collectively, the “Oracle Exchanges”). The market prices on the Oracle Exchanges were averaged and used to determine the prices of digital assets available to trade on Mango Markets, including its pricing of MNGO and USDC.¹²

THE ALLEGED SCHEME

The CFTC Complaint alleges that, prior to October 11, 2022, the Defendant created two anonymous accounts on Mango Markets and funded each with \$5 million in USDC stablecoin

assets. Notably, Mango Markets did not require any identifying information to create an account. In one anonymous account, the Defendant established a \$19 million long position consisting of over 400 million “perpetual contracts” between MNGO and USDC (“MNGO-USDC Swaps”).¹³ In the other anonymous account, the Defendant established a short swap position of the same size.¹⁴ By placing himself on both sides of the same transaction, the Defendant allegedly engaged in a wash trade. Furthermore, the DEX would not be aware that the Defendant was on both sides of the same transaction.

The CFTC Complaint alleges that, on October 11, 2022, during a 30-minute period, the Defendant bought large volumes of MNGO on each of the Oracle Exchanges in order to inflate the asset’s price on the Oracle Exchanges. The Defendant allegedly took steps to conceal his identity while trading on the Oracle Exchanges. On one constituent exchange, the Defendant used a false name and identification to create his account, and on another he used a virtual private network to falsely show his location as Poland.¹⁵ The CFTC Complaint alleges that, as a result of Defendant’s activity, the price of MNGO on the Oracle Exchanges increased substantially. In turn, Mango Markets used the inflated prices to value the Defendant’s MNGO-USDC Swaps.¹⁶

The CFTC Complaint asserts that this, in turn, resulted in a significant impact on Defendant’s long MNGO-USDC Swaps, which appreciated to an artificial value of more than \$200 million.¹⁷ Following this, the Defendant used the new value of his swaps to “borrow” \$114 million worth of digital assets from Mango Markets before immediately moving these funds to alternate platforms away from Mango Markets.¹⁸ The assets

the Defendant “borrowed” from Mango Markets represented virtually all available liquidity on the platform. According to the CFTC Complaint, the Defendant did not intend to pay back the borrowed assets, leaving the exchange with the MNGO positions as collateral. However, after the Defendant artificially increased the price of MNGO and withdrew his “borrowed” assets from Mango Markets, the value of MNGO and the MNGO-USDC Swaps quickly decreased.¹⁹

AFTERMATH

The CFTC Complaint alleges that, on October 12, 2022, the Defendant contacted Mango Markets’ administrators, offering to return a portion of the liquidated assets if Mango Markets agreed to a number of conditions, including not pursuing criminal charges and permitting Defendant to keep the remaining assets in his possession as a “bug bounty.”²⁰ A bug bounty is a reward for alerting the administrators of a decentralized finance platform to software vulnerabilities. After some negotiation between the Defendant and the administrators, the Defendant returned approximately \$67 million worth of tokens, keeping \$47 million worth as a bug bounty. The CFTC Complaint charges that Mango Markets used the returned tokens, as well as \$25 million from its own treasury, to compensate Mango Markets users that were harmed by the Defendant’s scheme.²¹ After this, the Mango Markets administrators sued the Defendant for \$47 million, arguing that the bug bounty was negotiated under duress, though the court stayed the case pending resolution of the DOJ’s criminal matter.²²

The Defendant, a high-profile social media user, detailed his trading activity during the relevant period with his more than 40,000 Twitter

followers, including disclosing that he recently operated a “highly profitable trading strategy” that he viewed as being completely legal.²³ He also suggested that a motivation for his trading activity was to point out a technical issue he felt should be addressed.²⁴ The Defendant also shared the details of his plan on an internet chatroom prior to engaging in the alleged scheme.²⁵ The Defendant appears to be taking the view that his actions embody the “code is law” philosophy, which some view to posit that a person may permissibly make any trade that is permitted by the computer code underlying a platform. However, commenters have noted that the government does not share this sentiment, particularly when potential fraud or market manipulation is involved.²⁶

TAKEAWAYS AND INSIGHTS

The CFTC Complaint offers a number of insights about the CFTC’s legal positions. First and foremost, the CFTC’s enforcement action here should serve as a warning to market participants that, despite a lack of express regulation, the CFTC views trading activity on decentralized platforms to be within its jurisdiction and will bring enforcement actions for fraudulent or manipulative conduct.

Second, the CFTC Complaint represents another data point in the ongoing debate over how certain digital assets should be characterized. The CFTC Complaint illustrates the CFTC’s view that virtual currencies like bitcoin, ether, and USDC are commodities subject to its jurisdiction.²⁷ But the CFTC Complaint falls short of explicitly stating that the CFTC views MNGO, a digital token, as a commodity under the CEA. Instead, the CFTC Complaint empha-

sizes that the CFTC has jurisdiction over MNGO-USDC Swaps because they appear to be financially settled transactions based upon a notional quantity of a CFTC jurisdictional commodity, USDC. The CFTC Complaint does not discuss whether MNGO is a non-security commodity, and relatedly, whether the MNGO-USDC Swap is a mixed swap. The CFTC’s allegations would allow for an inference that MNGO could be classified as a commodity. That said, the SEC’s action against the Defendant explicitly stated that MNGO is a security.²⁸

Third, these events highlight the inherent risks of operating a decentralized exchange that also offers asset lending to customers. Although platforms might wish to increase their customer base by providing multiple services, this case demonstrates the inherent risk in combining a DEX and a decentralized lending platform.

Fourth, Mango Markets’ platform, which allowed users to create accounts anonymously, made it difficult to detect wash trading. The CEA’s prohibition against wash trading applies to all swaps, whether executed on an exchange or over the counter. Because Mango Markets allowed users to create accounts anonymously, there was no way for the platform or the CFTC to monitor whether there was a common beneficial owner on both sides of a swap position.

Finally, the CFTC Complaint does not discuss whether Mango Markets should have been registered with the CFTC as a swap execution facility (“SEF”) or a designated contract market (“DCM”). Although the focus of the CFTC Complaint was the Defendant’s manipulative conduct, the CFTC has reiterated the registration requirement for entities that meet the definition of a SEF

or a DCM, recently noting that this requirement also applies to decentralized platforms.²⁹

ENDNOTES:

¹Complaint at 1, *Commodity Futures Trading Comm'n v. Avraham Eisenberg*, No. 23-cv-00173 (S.D.N.Y. Jan. 9, 2023) (the "CFTC Complaint").

²Complaint, *United States Securities and Exchange Comm'n v. Avraham Eisenberg*, No. 1:23-cv-00503 (S.D.N.Y. Jan. 20, 2023). A summary of the SEC's action against the Defendant is available at <https://www.willkie.com/-/media/files/publications/2023/secenforcementactionscurtinizesgovernancetokendesi.pdf>.

³Complaint, *United States of America v. Avraham Eisenberg*, No. 1:22-mj-10337-UA (S.D.N.Y. Dec. 23, 2022).

⁴De, Nikhilesh & Nelson, Danny, *Mango Markets Exploiter Eisenberg Arrested in Puerto Rico*, COINDESK (Dec. 27, 2022), available at <http://www.coindesk.com/policy/2022/12/27/mango-markets-exploiter-eisenberg-arrested-in-puerto-rico/>.

⁵Memo Endorsement Granting Motion to Stay, *Commodity Futures Trading Comm'n v. Avraham Eisenberg*, No. 23-cv-00173 (S.D.N.Y. Mar. 13, 2023), ECF No. 15; *United States Securities and Exchange Comm'n v. Avraham Eisenberg*, No. 1:23-cv-00503 (S.D.N.Y. Mar. 13, 2023), ECF No. 16.

⁶A summary of the CFTC's prior settlement with Tether is available at <https://www.willkie.com/-/media/files/publications/2021/10/cftcetetherkrakenbitfinex.pdf>.

⁷Complaint at 30, *United States Securities and Exchange Comm'n v. Avraham Eisenberg*, No. 1:23-cv-00503 (S.D.N.Y. Jan. 20, 2023).

⁸CFTC Complaint at 6.

⁹*Id.* at 6.

¹⁰*Id.* at 8.

¹¹*Id.* at 5.

¹²*Id.* at 2.

¹³*Id.* at 9.

¹⁴*Id.* at 9.

¹⁵*Id.*

¹⁶*Id.*

¹⁷*Id.* at 11.

¹⁸*Id.*

¹⁹*Id.* at 11-12.

²⁰*Id.* at 12.

²¹*Id.* at 13.

²²Complaint at 4, *Mango Labs, LLC v. Avraham Eisenberg*, No. 23-cv-665 (S.D.N.Y. Jan. 25, 2023); Order Granting Motion to Stay and Intervene, *Mango Labs, LLC v. Avraham Eisenberg*, No. 23 Civ. 665 (S.D.N.Y. Apr. 12, 2023), ECF No. 54.

²³Muyao Shen, *Crypto Trader's Fraud Charges Show DeFi Isn't Outside the Law*, BLOOMBERG (Dec. 28, 2022), available at <https://www.bloomberg.com/news/articles/2022-12-28/crypto-trader-s-fraud-charges-over-mango-exploit-show-defi-isn-t-outside-the-law>.

²⁴*Id.*

²⁵CFTC Complaint at 13-14.

²⁶Muyao Shen, *Crypto Trader's Fraud Charges Show DeFi Isn't Outside the Law*, BLOOMBERG (Dec. 28, 2022), available at <https://www.bloomberg.com/news/articles/2022-12-28/crypto-trader-s-fraud-charges-over-mango-exploit-show-defi-isn-t-outside-the-law>.

²⁷CFTC Complaint at 5.

²⁸Complaint at 30, *United States Securities and Exchange Comm'n v. Avraham Eisenberg*, No. 1:23-cv-00503 (S.D.N.Y. Jan. 20, 2023).

²⁹A summary of a recent enforcement action against a decentralized protocol is available at <https://www.willkie.com/-/media/files/publications/2022/cftcbringsfirstofitskindlawsuitagainstdenraliz.pdf>.

