

A Fractured Framework: Regulatory Actions Against Mango Token Trader Highlight Complexities of Crypto Enforcement

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Key Points

- The recent indictment and multiple regulatory enforcement actions brought against a crypto trader alleged to have committed market manipulation highlight the ongoing fractured oversight of the crypto markets in the United States and the application of multiple laws to the world of decentralized crypto trading.
- The actions involve varying theories of wrongdoing, with the SEC alleging the token was a security, the CFTC asserting jurisdiction through the involvement of a swap tied to the token and the DOJ using both its broad wire fraud authority and the criminal reach of the CEA—but not the federal securities laws—as the basis for its charges.
- The SEC action was filed the same day that SEC Commissioner Hester Peirce made her latest case for rulemaking in the space and an end to the government’s “regulation by enforcement” approach.

Background

Avraham “Avi” Eisenberg, 27, a crypto trader accused of perpetrating a \$100 million market manipulation scheme on the Mango Markets digital asset platform, is facing charges from the U.S. Department of Justice (DOJ), the U.S. Commodity Futures Trading Commission (CFTC) and the U.S. Securities and Exchange Commission (SEC) in addition to a private action from Mango Markets.

According to its website, Mango Markets is a decentralized exchange run by the Mango Decentralized Autonomous Organization (DAO). Mango Markets utilized the Solana blockchain to facilitate direct, peer-to-peer digital asset transactions of virtual currencies, such as bitcoin, ethereum and USD Coin (USDC), a stablecoin pegged to the value of the U.S. dollar. The Mango DAO makes governance decisions based on votes by individuals who hold the “MNGO” token. Mango Markets also offered a borrowing function that allowed users to borrow crypto assets in amounts based on the value of the borrower’s Mango Markets portfolio and to withdraw those borrowed assets from Mango Markets.

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Eisenberg allegedly created two anonymous accounts on Mango Markets, which he used to establish large leveraged positions in a swap contract whose value was based upon the relative price of MNGO and USDC. He then rapidly purchased substantial quantities of MNGO on three digital asset exchanges that were the inputs for the “oracle,” or data feed, that Mango Markets used to determine the value of Eisenberg’s swap positions. As a result of Eisenberg’s allegedly manipulative trading, the price of MNGO as reported by the oracle jumped over 13-fold during a 30-minute span, resulting in a temporary spike in the value of Eisenberg’s swap positions. Eisenberg then cashed out his profits by using the inflated value of his swaps as collateral to withdraw over \$110 million in digital assets from Mango Markets, effectively draining all available assets from the Mango Markets platform.

Shortly after these events, Eisenberg engaged in a negotiation with the Mango DAO, and in a settlement agreement, seemingly intended to ensure the ongoing liquidity of Mango Markets. Per the settlement agreement, Eisenberg agreed to return a portion of the digital assets on the condition that Mango Markets agreed, among other things, not to “pursue any criminal investigations or freezing of funds.” Eisenberg returned approximately \$67 million to Mango Markets, while retaining approximately \$47 million worth of various digital assets.

Subsequently, Eisenberg, who has over 41,000 followers, bragged about his attack on Twitter and other social media platforms.

The Charges Against Eisenberg

- On December 23, 2022, in a three-count complaint brought in the Southern District of New York (SDNY), the DOJ charged Eisenberg with commodities fraud, commodities manipulation and wire fraud. A grand jury returned an indictment with the same three charges on January 9, 2023.
- On January 9, 2023, the CFTC brought charges against Eisenberg in SDNY for using fraudulent and manipulative conduct to obtain more than \$100 million worth of digital assets from Mango Markets. This is the CFTC’s first enforcement action for a fraudulent or manipulative scheme involving trading on a decentralized digital asset platform, and its first involving a scheme that is sometimes called “oracle manipulation.”
- On January 20, 2023, the SEC charged Eisenberg in SDNY with violating anti-fraud and market manipulation provisions of the securities laws. According to the SEC, Eisenberg orchestrated an attack on Mango Markets by manipulating the MNGO token, a so-called “governance token” that was offered and sold as a security.
- Finally, on January 25, 2023, Mango Labs, the company behind Mango Markets, jumped into the ring and brought private charges against Eisenberg in SDNY for conversion, fraudulent misrepresentation, unjust enrichment and a declaratory judgment rescinding the settlement agreement.

Takeaways

1. Eisenberg’s case highlights the fractured regulatory framework for enforcement of crypto assets.

By virtue of the Commodity Exchange Act (CEA), the CFTC has regulatory authority over digital assets that are classified as “commodities,” while the SEC, pursuant to the

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federal securities laws, has regulatory authority over digital assets that are “securities.” Eisenberg’s case reflects the complexities around each regulator’s enforcement authority when it comes to crypto assets.

The DOJ, which was the first to bring charges against Eisenberg, relied on its broad wire fraud authority and the criminal reach of the CEA—but not the federal securities laws—as the basis for its charges for commodities fraud and commodities manipulation. The DOJ cited as precedent *CFTC v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018), which held that virtual currencies are commodities under the CEA and are therefore subject to the CFTC’s anti-fraud and anti-manipulation enforcement authority. In its complaint, the DOJ alleged that “virtual currencies, such as USDC, are ‘commodities’ under the Commodity Exchange Act,” and that Eisenberg’s manipulation scheme violated the CEA by artificially inflating the value of USDC/MNGO swap contracts. However, the DOJ left open the question of how to classify the MNGO token.

Next, the CFTC brought charges against Eisenberg, in what is the CFTC’s first ever enforcement action involving trading on a decentralized digital asset platform. Consistent with the spirit of *McDonnell*, the CFTC case demonstrates that the CFTC views trading on decentralized digital asset platforms as within its jurisdiction despite the lack of express regulation. Like the DOJ, the CFTC complaint emphasized in no uncertain terms that USDC is a commodity—and thus subject to the CFTC’s jurisdiction—but the CFTC fell short of stating whether MNGO could be a commodity.

Meanwhile, the SEC, which was last to bring charges, meticulously laid out the case for why MNGO, “a so-called governance token,” is a security. This is consistent with recent commentary from Chair Gary Gensler, who has expressed the view that the majority of crypto-tokens are securities.¹

2. The SEC is focused on governance-related principles as hallmarks of decentralization.

In 2018, William Hinman, then-Director of the Division of Corporate Finance at the SEC, delivered the now-famous remarks, “[i]f the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract.”² Since this speech, which followed the SEC’s “DAO Report,” many crypto products have launched with the goal of achieving decentralization and thus avoiding the application of a key prong of the “Howey Test”—enunciating in the 1946 U.S. Supreme Court decision that the SEC relies upon to determine whether a product is an investment contract, the value of which is tied to the efforts of others, and thus a security. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946) (Under the Howey Test, an “investment contract” exists where there is (i) an investment of money, (ii) in a common enterprise, (iii) with a reasonable expectation of profit and (iv) to be derived from the efforts of others.).

Fast forward to 2023 and the landscape has changed significantly, including with the emergence of so-called “governance tokens.” Governance tokens are a relatively new kind of cryptocurrency that give token voting rights over how blockchain projects are developed, operated and run. The decentralized governance model helps align the interests of token holders and the blockchain project, and, again, bring the product away from the framework of the Howey Test.

The SEC's allegation that MNGO is a security highlights the agency's ongoing skepticism of the concept of decentralization and its lack of belief that Mango Markets was an actual DAO that would bring it into the realm described by Hinman. In another recent enforcement action, the SEC also claimed that governance tokens are investment contracts.³

The very day that the SEC announced charges against Eisenberg, Commissioner Hester M. Peirce delivered a speech at Duke Conference discussing cryptocurrency lessons for the future. Her remarks focused on how the state of regulation-by-enforcement is so fractured. Putting little faith in the SEC to establish a regulatory regime that brings efficiency and clarity, she called upon those who "believe in crypto's future . . . not [to] wait for regulators to fix the problems that bubbled to the surface in 2022."⁴

3. Eisenberg's case serves as a warning about the dangers associated with discussing crypto trading strategy on social media.

Not unlike Sam Bankman-Fried, who tweeted incessantly as FTX was collapsing, Eisenberg had a highly active social media presence that has undoubtedly contributed to the charges he now faces, and which will make defending against the charges all the more challenging. On October 15, 2022, he **announced** on Twitter:

"I was involved with a team that operated a highly profitable trading strategy last week. I believe all of our actions were legal open market actions, using the protocol as designed, even if the development team did not fully anticipate all the consequences of setting parameters the way they are. Unfortunately, the exchange this took place on, Mango Markets, became insolvent as a result, with the insurance fund being insufficient to cover all liquidations. This led to other users being unable to access their funds. To remedy the situation, I helped negotiate a settlement agreement with the insurance fund with the goal of making all users whole as soon as possible as well as recapitalizing the exchange."⁵

Less than two weeks later, on October 28, 2022, Eisenberg gave an interview on the podcast "Unchained," where, after the host introduced him as the "Mango Markets Attacker," he discussed negotiating the settlement agreement with Mango Markets. When asked to share his views on coming out publicly and claiming to be a part of "economic attacks" or arbitrage trades, he responded, "[i]f you're out there and you're public you're kind of painting a target on yourself but, it is what it is."⁶ The government will likely rely on Eisenberg's public statements about his trading strategy as evidence that he acted with manipulative intent, a central element of the charges against him.⁷

¹ SEC Chair Gary Gensler, Prepared Remarks at SEC Speaks, "Kennedy and Crypto" (Sept. 8, 2022), <https://www.sec.gov/news/speech/gensler-sec-speaks-090822>.

² William Hinman, Prepared Remarks at the Yahoo Finance All Markets Summit: Crypto, "Digital Asset Transactions: When Howey Met Gary (Plastic)" (June 14, 2018), <https://www.sec.gov/news/speech/speech-hinman-061418>.

³ See SEC Press Release 2021-145, SEC Charges Decentralized Finance Lender and Top Executives for Raising \$30 Million Through Fraudulent Offerings (Aug. 6, 2021), <https://www.sec.gov/news/press-release/2021-145>.

⁴ Commissioner Hester M. Peirce, Remarks Before the Digital Assets at Duke Conference (Jan. 20, 2023), <https://www.sec.gov/news/speech/peirce-remarks-duke-conference-012023>.

⁵ https://twitter.com/avi_eisen/status/1581326199682265088?lang=en.

⁶ <https://www.youtube.com/watch?v=e-y4WmrndQ4>.

⁷ The SEC, CFTC and some courts have taken the position that otherwise legal open-market transactions can violate the anti-manipulation provisions of the CEA and federal securities laws if they are executed with an intent to move a market price. See Michael A. Asaro, *Spoofing: The SEC Calls It Manipulation, But Will Courts Agree?*, N.Y.L.J. (July 17, 2017), <https://www.akingump.com/a/web/59261/Asaro.Williams.NYLJ.pdf>.

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