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Top 5 Digital Asset Litigation and Investigation Trends of 2022

George A. Stamboulidis and Christina O. Gotsis*

In this article, the authors review the litigation and investigation trends that have emerged this year with respect to cryptocurrency and digital assets.

Cryptocurrency and digital assets have kept courts and regulators busy as digital assets continue to pose new questions and challenges for anyone involved in their sale, trade, or development. The following trends have emerged this year as a likely indicator of what is on the horizon.

1. Courts Allow Service of Process Via Non-Fungible Tokens

Far from just typical art, non-fungible tokens ("NFTs") have had a profound impact on the legal landscape and litigation process—on service of process, to be exact. This year, a New York court and a UK court have allowed plaintiffs to serve anonymous defendants by dropping NFTs of the legal documents into wallets that are believed to belong to them. The High Court of England and Wales allowed the founder of an online gambling company to file suit against unnamed individuals connected to two digital wallets that were used to defraud him of $2.1 million. This came after the New York Supreme Court rendered a landmark decision allowing plaintiffs to deliver service to a wallet that an algorithmic forensic analysis identified as belonging to an alleged hacker who executed an $8 million attack on an exchange. If the wallet owner fails to respond to the summons, the allegedly stolen digital assets in that wallet will be frozen. In the digital asset space where arresting fraudsters remains difficult, these developments indicate the courts' willingness to adapt in the pursuit of justice, even in an area of the law that has historically been strict in its requirements.

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2. The Internal Revenue Service Returns to the Use of the John Doe Summons

This year, the Internal Revenue Service ("IRS") appears to have reverted to its use of the John Doe summons to identify and investigate underreporting in connection with cryptocurrency transactions. This effort is largely in support of its Operation Hidden Treasure, announced in 2021, which had the goal of rooting out tax evasion in the digital asset space. In August 2022, a California court approved the service of a John Doe summons on digital asset platform sFOX, seeking user identity information and transaction activity for taxpayers who conducted at least $20,000 in transactions between 2016 and 2021. The summons is the fourth of its kind issued against digital asset platforms. IRS Commissioner Chuck Rettig expressed that John Doe summonses are a "highly valuable enforcement tool that the government will use again and again to catch tax cheats," suggesting that such enforcement is likely to continue into 2023.

3. The Department of Justice Broadens Its Investigative Scope into Digital Asset Fraud

This past summer, the Department of Justice ("DOJ") brought its first-ever action for cryptocurrency insider trading, charging a former digital asset platform employee and two others in a scheme to use confidential information about which digital assets were scheduled to be listed on the platform's exchange. The indictments allege that on at least 14 occasions between 2021 and 2022, the employee tipped off his brother and/or friend that the platform planned to list particular assets, and shared the timing of the public announcements. After receiving these tips, the tippees used anonymous blockchain wallets to acquire the crypto assets shortly before the platform announced its listing and sold at least 25 different digital assets for a profit of at least $1.5 million. This case, brought by the U.S. Attorney's Office in the Southern District of New York, demonstrates that the DOJ is broadening its investigative scope into a wider array of digital asset frauds.

4. Regulatory Coordination Increases

The Securities and Exchange Commission ("SEC") used the DOJ's first crypto insider trading case to launch a parallel enforcement action in its continued struggle to bring certain digital assets within its purview. In its complaint, the SEC declared nine digital tokens to be "securities" without formally charging the token issuers or the listing exchanges, unlike in its prior complaints in the digital asset space. Following an announcement that it would nearly double the size of its Crypto Assets and Cyber Unit, the SEC has kept its foot on the gas pedal, ramping up enforcement efforts against digital asset exchanges, platforms, and fraudsters. The SEC's creative approach in piggybacking on the DOJ's action may be a sign of increased regulatory coordination heading toward the end of the year.

5. A Multitude of Other State and Federal Enforcement Actions Emerge

The SEC and DOJ are not the only agencies with digital assets in their crosshairs. As of May 2022, Commodity Futures Trading Commission ("CFTC") Chairman Rostin Benham announced that the CFTC had already brought 23 enforcement actions in the digital asset space for the fiscal year, nearly half the number of total cases brought involving digital assets since 2015. In June 2022, the CFTC filed its largest-ever fraud scheme case in a civil action against a foreign currency commodity pool and its operator for engaging in a multilevel marketing scheme that solicited bitcoin from investors and absconding with the funds. Multiple state agencies also appear to be jumping in the crypto enforcement arena, with the New York Department of Financial Services bringing its first crypto enforcement action against the crypto trading unit of an investment platform for failing to maintain and certify anti–money laundering and cybersecurity programs. As of March 2022, Texas had brought about 150 crypto-related enforcement actions, according to the director of the enforcement division of the State Securities Board. The increased involvement by agencies other than the DOJ and SEC signals that enforcement will be strong across all fronts, both state and federal.

Conclusion

- Digital assets have pushed courts to adapt traditional litigation procedures to provide relief to defrauded plaintiffs.
- Government agencies have also ramped up enforcement efforts while increasing agency coordination, broadening investigative scopes, and using special tools to root out digital asset fraud.

Note

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