CLIENT ALERT

SEC Charges Cryptoasset Platform as a Ponzi Scheme

Founders and Promoters of Forsage.io Charged in a $300 Million Scheme

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On August 1, 2022, the Securities and Exchange Commission ("SEC" or the "Commission") sued eleven individuals associated with the cryptoasset platform Forsage.io ("Forsage") in the North District of Illinois, alleging one count of the offer and sale of unregistered securities and four counts of fraud under the Securities Exchange Act of 1934.[1] Along with the four international co-founders of the platform, the SEC charged three Americans hired by Forsage to promote the platform through social media and five Americans who led the largest promotional efforts on behalf of Forsage.[2] The SEC is seeking a permanent injunction, disgorgement, and a civil penalty. Two of the charged individuals have settled the charges, without admitting fault, and agreed to be permanently enjoined from future violations of the charged provisions and certain other activity. Forsage, as a platform, has previously been subject to cease and desist actions for operating an unregistered security by both the Securities and Exchange Commission of the Philippines and the Montana Commissioner of Securities and Insurance.

Forsage was a platform that interacted with the Ethereum, Tron, and Binance blockchains to direct funds to investors as additional investors were recruited into the scheme. To participate in the platform, an investor would purchase a "slot" within the platform using one of the native tokens of the three blockchains. Once the purchase was made, the investor

1 Complaint, *United States v. Okhotnikov*, No. 22-cv-3978 (N.D. Ill. Aug. 1, 2022)

2 One of the defendants in the case was included in both groups.

ceded to the platform all control over the disposition of the contributed crypto token used for the purchase. In turn, the investor could gain a return of the investment either through recruiting additional investors to purchase “slots” within the platform or through a disbursement of any increase in the overall value of the crypto token portfolio across the entire platform. Forsage did not create any particular crypto token or any new development to blockchain technology.

The complaint focuses on the multi-level nature of the investment structure and the lack of a tangible product provided by Forsage. It also alleges that for certain “slot” purchases, the crypto tokens used for the purchases were diverted to accounts divorced from any particular investor. Investors expected the actions of the various defendants to grow their investments, while the defendants solely focused on increasing recruitment efforts into the platform without any back-end investment activity. Instead, the only operational actions taken by Forsage involved receiving the crypto tokens in connection with the slot purchases.

Among other things, this case demonstrates the need for robust due diligence when making a substantial investment within the cryptoasset space. The ancillary opportunities within this market should be strictly scrutinized before any investment is made. Further, as the SEC continues to develop its enforcement strategy related to cryptoassets, this action serves as an important reminder that the Commission is inclined to treat many blockchain enterprises as involving securities offerings subject to regulation. While the case appears to be a more traditional fraud fact pattern, the inclusion of the first charge, for the offer and sale of an unregistered security, is an important sign that the SEC is continuing to take an aggressive posture towards the applicability of the securities laws to cryptoassets and associated platforms. Any development in this space should be undertaken with care to consider the implications of the securities laws on all aspects of the product under development. Project teams and developers should focus on providing a concrete service or product to investors or customers to avoid accusations that the project involves a Ponzi scheme.

Investors should nonetheless take some comfort in the SEC maintaining a regulatory focus on more traditional fraudulent schemes within the cryptoasset ecosystem. This should help to provide more stability to the area as the threat of enforcement permits legitimate enterprises to rely on investor confidence, built on the idea that enforcement activity is serving as a deterrent for fraudulent activity.

Willkie will continue to monitor developments in this case and the SEC’s broader enforcement approach towards the cryptoasset industry.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

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