

DOJ Charges Wire Fraud (Read, Insider Trading) in NFTs

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In a recently unsealed indictment, the Department of Justice (“**DOJ**”) charged Nathaniel Chastain with wire fraud and money laundering in a scheme that has been billed as “insider trading.” Chastain was previously a product manager tasked with selecting non-fungible tokens (“**NFTs**”) to be displayed on the homepage of OpenSea, one of the largest and most popular NFT marketplaces. At the time of this alleged scheme, OpenSea had a confidentiality policy in place that prohibited using OpenSea’s confidential business information except to perform work for OpenSea; Chastain signed an agreement acknowledging this duty of confidence when he joined OpenSea. The DOJ alleges that from approximately June 2021 to September 2021, Chastain “misappropriated OpenSea’s confidential business information” regarding which NFTs would be featured on its homepage. According to the indictment, Chastain used this confidential information to purchase dozens of NFTs prior to their homepage debuts and subsequently sold them after they were featured, resulting in a return to Chastain anywhere between two to five times his purchase price. To conceal the operation, the DOJ contends that Chastain used anonymous Ethereum wallets and OpenSea accounts rather than those publicly held in his name. Nonetheless, a Twitter user uncovered Chastain’s ownership of some of the Ethereum wallets buying NFTs before they landed on OpenSea’s homepage. This discovery led OpenSea to request Chastain’s resignation, and ultimately, to his indictment.

1. WHAT IS AN NFT?

An NFT is a digital asset that exists and lives on a blockchain, which, broadly described, is a digital, decentralized ledger that stores information and whose accuracy is verified by the combined computing power of its users rather than a single intermediary. NFTs are often associated with a digital object that provides proof of the digital object’s ownership and a license to use the object for all or some purposes. NFTs have recently gained prominence as an avenue for buying and selling digital artwork, among other uses, and some NFTs sell for millions of dollars. An NFT’s ownership and rights are automatically verified and enforced by the NFT’s code on the blockchain. The Ethereum blockchain is the most popular chain for creating—or “minting”—NFTs, in part because the Ethereum blockchain enables “smart contracts.” Generally, a smart contract is a computer program that automatically executes certain actions according to predetermined terms. For example, a smart contract could allow an NFT creator to retain his rights to revenue or royalties with respect to future sales or uses of an NFT, for example.

2. WHAT IS “INSIDER TRADING”?

While Chastain’s alleged wrongdoing is rightly called “insider trading,” Chastain was not charged as most insider-trading-defendants are. As is typically prosecuted, insider trading is prohibited under the Securities Exchange Act of 1934 (the “Exchange Act”) as a “device, scheme or artifice to defraud . . . in connection with the purchase or sale of any security.” Insider trading is more a colloquial term referenced in court decisions, and it is not specifically defined or prohibited by any federal law, despite several Congressional proposals to do so. Instead, insider trading is “by historical accident, a creature of the securities laws.”

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