

[Securities Regulation Daily Wrap Up, ENFORCEMENT—Cryptocurrency scammers rely on familiar fraud schemes, \(Jan. 19, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Brad Rosen, J.D.](#)

The CFTC has brought two separate enforcement actions seeking injunctive relief in the U.S. District Court for the Eastern District of New York in connection with fraudulent solicitation involving virtual currencies, as well as the violation of other commodity laws and regulations.

In one action brought against Dillon Michael Dean of Longmont, Colorado, and his company, The Entrepreneurs Headquarters Limited, a U.K.-registered entity, the CFTC [charged](#) the defendants with engaging in a fraudulent scheme to solicit Bitcoin from members of the public, misrepresenting that customers' funds would be pooled and invested in products including binary options, making Ponzi-style payments to commodity pool participants from other participants' funds, misappropriating pool participants' funds, and failing to register with the CFTC as a CPO and Associated Person of a CPO.

In a second matter, also a fairly generic fraud action, the Commission [charged](#) defendants Patrick K. McDonnell, of Staten Island, New York, and his company, CabbageTech, Corp. d/b/a Coin Drop Markets (CDM), a New York corporation, with fraud and misappropriation in connection with purchases and trading of Bitcoin and Litecoin, as well as failing to register with the CFTC as required. The actions against both Dean and McDonnell involve the kind of garden-variety fraudulent conduct that the CFTC's enforcement division has pursued for many years. The twist here in both of these matters, is that virtual currencies have been brought front and center into the overall fraudulent schemes.

Cryptocurrency schemes. In the *Dean* matter, the Commission [alleged](#) that the defendants engaged in a fraudulent scheme, by which they solicited at least \$1.1 million worth of Bitcoin from more than 600 members of the public from approximately April 2017 through the present.

As part of that scheme, the defendants promised to convert Bitcoin into fiat currency to invest on the customers' behalf in a pooled investment vehicle for trading commodity interests. That included trading binary options on an online exchange which was a CFTC designated contract market. Instead, the defendants misappropriated over \$1 million in customers' funds, and used some of those funds to pay other customers in the manner of a Ponzi scheme.

In the *McDonnell* matter, the CFTC [alleged](#) that the defendants induced customers to send money and virtual currencies to CDM in exchange for real-time virtual currency trading advice to purchase virtual currencies, as well as to trade under McDonnell's direction. No such trading occurred, and those customers who provided funds to McDonnell and CDM to make purchases or trade on their behalf never saw those monies again. In short, McDonnell and CDM used their fraudulent solicitations to obtain and then simply misappropriated the customer funds.

The CFTC's complaint also alleged that the defendants failed to register with the Commission as required. However, the Commission's complaint did not contain any allegations with respect to the amount or extent of customer losses or injury, nor did it indicate the number of customers that were purportedly victimized by the defendants' wrongdoing.

In both the *Dean* and *McDonnell* actions, the CFTC is seeking restitution, disgorgement of ill-gotten gains, civil monetary penalties, permanent trading and registration bans, and a permanent injunction against further violations of the Commodity Exchange Act and CFTC regulations, as charged.

As confirmed by CFTC personnel, the Commission has also brought charges in a third case involving virtual currencies, but that matter remains under seal.

CFTC-SEC joint statement. Along with instituting these proceedings, CFTC Director of Enforcement James McDonald took the occasion to issue [a joint statement](#) regarding virtual currency related enforcement actions with his SEC counterparts, Enforcement Co-Directors Stephanie Avakian and Steven Peikin. That statement repeats some familiar themes, and provides:

"When market participants engage in fraud under the guise of offering digital instruments – whether characterized as virtual currencies, coins, tokens, or the like the SEC and the CFTC will look beyond form, examine the substance of the activity and prosecute violations of the federal securities and commodities laws." The joint statement continues, "The Divisions of Enforcement for the SEC and CFTC will continue to address violations and to bring actions to stop and prevent fraud in the offer and sale of digital instruments."

The cases are [No. 18-cv-00345](#) (Dean) and [No. 18-cv-00361](#) (McDonnell).

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