

Securities Regulation Daily Wrap Up, TOP STORY—E.D.N.Y.: Court imposes penalties of nearly \$1.2M in CFTC suit targeting CabbageTech virtual currency fraud, (Aug. 24, 2018)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The CFTC handily won its federal civil suit against Patrick McDonnell and his CabbageTech, Corp., both of whom the agency had accused of engaging in a fraudulent scheme related to virtual currencies. CabbageTech was defaulted because it never appeared in court via counsel as all corporations must do, and McDonnell, who represented himself at trial, had testified under oath in a deposition that he did not recall key events cited by the CFTC, such as developing virtual currencies or that customers had requested refunds. U.S. District Court Judge Jack Weinstein, after a four-day bench trial, found the CFTC proved its allegations that McDonnell and CabbageTech violated Commodity Exchange Act Section 6(c)(1) and ordered that McDonnell and CabbageTech be permanently enjoined from further violations, ordered restitution of more than \$290,000, and imposed a civil monetary penalty of three times the amount of restitution ([CFTC v. McDonnell \(final judgment and order\)](#), August 23, 2018, Weinstein, J.).

"As the court's judgment makes clear, the CFTC will continue to act aggressively to identify bad actors involved in virtual currencies and hold them accountable," [said](#) CFTC Director of Enforcement James McDonald.

"This case also shows the CFTC's readiness to prove its case at trial." The McDonnell case was brought in conjunction with the Virtual Currency Task Force within in the CFTC's Enforcement Division.

Evidence overwhelming. The court found sufficient evidence of all three things the CFTC had to prove: (1) that McDonnell and CabbageTech engaged in prohibited conduct; (2) scienter on the defendants' part; and (3) that the alleged violations were in conjunction with a contract for the sale of a commodity in interstate commerce. Prohibited conduct, said the court, could be in the form of a fraudulent scheme, material misrepresentation, misleading statement or deceptive omission, or a business practice that operates as a fraud.

The court described evidence that McDonnell had engaged in a fraudulent scheme in which he claimed to have a team of experts on digital assets while actually running his purported business from his home basement by himself. According to large swaths of the trial record cited by the court, the four witnesses credited by the court told similar stories of being drawn to McDonnell in order to benefit from his expertise in trading virtual currencies and then being spurned when they asked for their money back.

The court also catalogued McDonnell's numerous misrepresentations, omissions, and misleading statements regarding purported memberships for entry and exit guidance regarding virtual currencies; the memberships were to last for up to 12 months or longer, but McDonnell abruptly ended them. The court further noted that McDonnell had promised outsized performance but instead misappropriated customer funds and issued false reports. The court concluded that McDonnell's representations were material because the facts would have been important to customers making investment decisions.

In its 139-page opinion, the court also detailed some of the more challenging aspects of managing the case. Chief among them was McDonnell's persistent refusal to consider obtaining legal counsel despite the court's repeated admonitions that he needed counsel. McDonnell also only sporadically attended court sessions. Still, McDonnell managed to argue that the CFTC lacked authority to pursue its suit against him; the court acknowledged that one case from the U.S. District Court for the Central District of California ([CFTC v. Monex](#)) might aid McDonnell's theory but the court, as it did earlier this year, ultimately [rejected](#) McDonnell's argument.

A final consideration was McDonnell's belated request for a jury trial; the court had granted the CFTC's motion to waive its jury demand on the last day of the bench trial, a day on which McDonnell did not attend summations or oppose the CFTC's motions and, thus, did not object to the CFTC's motion regarding a jury trial. As a result, the court set aside constitutional and administrative law concerns and found that, based on the "special circumstances" of the case, McDonnell had no right to a jury trial and that all relevant facts were proven beyond a reasonable doubt.

Penalties. According to relevant law, the court can enjoin someone's conduct if there is a reasonable likelihood of repetition by way of future violations. The court characterized McDonnell's and CabbageTech's conduct as "a recurrent, systematic process of egregious intentional violations" of the CEA. Based on this conclusion, the court imposed a permanent injunction that includes, among other things, a ban on trading virtual currency.

The court also ordered restitution of \$290,429. The court reasoned that McDonnell and CabbageTech never intended to provide the promised services and instead planned to misappropriate investors' funds. The amount of restitution, thus, would be the full amount of customers' losses after deductions for amounts that were not part of the fraudulent scheme (\$164,700) and for a much smaller amount (\$2,264) in virtual currency returned by McDonnell to a customer. Moreover, given the severity of McDonnell's and CabbageTech's conduct, the court also imposed a civil monetary penalty of \$871,288—three times the amount of restitution.

The case is [No. 18-cv-00361](#).

Attorneys: David William Oakland for the CFTC. Patrick McDonnell pro se.

Companies: CabbageTech, Corp. d/b/a Coin Drop Markets

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