

3 Wobbly Defenses From Bankman-Fried's Substack Post

By **Laurel Grass** (February 1, 2023)

FTX, the second-largest cryptocurrency exchange in the world, opened November 2022 with a multibillion-dollar market value, but on Nov. 2 and 6, tweets from Coindesk and Binance, respectively, concerning Sam Bankman-Fried's company alarmed the industry, and FTX's value spiraled down to nothing.

The tweets caused crypto markets to reassess co-founder and then-CEO Bankman-Fried's business practices, and industry experts, competitors and U.S. government officials accused him of misappropriating funds.



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In days, Bankman-Fried, also the co-founder of crypto trading firm Alameda Research and the richest 29-year-old in the world, lost his net worth, save for a few hundred thousand dollars. On Dec. 12, plucked from his Bahamian villa, he found himself in jail and looking for a defense.

Bankman-Fried released his defense in a Substack post on Jan. 12, 2023.[1] In an extraordinarily uncommon move, he published FTX's finances and proposed rescue, saying if only the Feds would unblock the data wall, all could be fixed. And most recently, prosecutors sought to restrict Bankman-Fried's bail release conditions due to his communications.

The Criminal and Civil Charges Bankman-Fried Must Defend

On Dec. 12, Bankman-Fried was arrested in the Bahamas at the request of the U.S. Attorney's Office for the Southern District of New York. The U.S. attorney indicted him with wire fraud statutes, election violations and forfeiture.[2]

The eight-count indictment of wire fraud or conspiracy to commit wire fraud involves penalties including prison terms beyond the normal life expectancy of a 30-something defendant, fines and restitution.

After Bankman-Fried was indicted, two federal agencies levied more charges: civil allegations of fraud, deceit and artifice. On Dec. 13, the U.S. Commodity Futures Trading Commission filed civil enforcement actions for fraud and injunctive relief.[3]

As the CFTC's complaint alleges, "At Bankman-Fried's direction, FTX executives ... created features in the underlying code for FTX that allowed Alameda to maintain an essentially unlimited line of credit on FTX." [4] In Delaware bankruptcy court, FTX attorney Andrew Dietderich characterized this as a "backdoor" that was "created ... by inserting a single number into millions of lines of code for the exchange, creating a line of credit from FTX to Alameda, to which customers did not consent." [5]

Also on Dec. 13, the U.S. Securities and Exchange Commission charged Bankman-Fried with violating the Securities Act, the Exchange Act and SEC Rule 10b-5, [6] based on Bankman-Fried's alleged multibillion-dollar deceptive schemes.

Viability Estimate of Bankman-Fried's Blogged Defenses

Days after Bankman-Fried was released on bond and given an ankle bracelet by the feds and a dog from his parents, he wrote his "Pre-Mortem" blog post[7] exposing his view of the FTX collapse.

Bankman-Fried's written defense colloquy from Jan. 12 on Substack, as well as his leaked testimony from his canceled congressional hearing, include rough charts and financials that try to refute the logic behind the FTX criminal and civil allegations.

Usually, in criminal and civil proceedings, defendants stay silent. They guard their defenses — often upon the advice of counsel.

But despite the fact that Bankman-Fried has splashed social media with prior admissions and confessions, his defense is that he wasn't paying attention and that he wasn't at the helm of Alameda, adding that he is sorry.[8]

We can categorize his defenses into three buckets: (1) The other guys did it, (2) FTX and Alameda had sloppy business practices, and (3) he was not aware of key corporate activity and coding mechanisms.

Remember, Bankman-Fried finds himself immersed in four federal agency matters: a criminal indictment in the U.S. District Court for the Southern District of New York, two civil enforcement filings by the SEC and CFTC, and a bankruptcy proceeding in Delaware.

The criminal proof requirement — proven guilty beyond a reasonable doubt — is the highest, while the civil proof is lower, but the evidence analysis should be substantially similar.

Bankman-Fried's criminal matter will include an overflow of evidentiary motions, or motions in limine. The Substack post presents an opportunity for both sides to argue the admission of his statements.

To disprove wire fraud and its sister statutes, Bankman-Fried must counter the prosecution's accusations that he and his cohorts committed fraud. And for him to support the "sloppy business practices," "unaware of coding and fancy tech mechanisms" and "the other guys did it" defenses, Bankman-Fried must beat claims of scienter, or the intent to defraud.

That is why, as described below, he attempts to portray himself as a victim of happenstance — which is what he needs to defeat the required intent to defraud.

Defense 1: The Other Guys Did It

One of Bankman-Fried's defenses is that he was not working at Alameda.

He refers to Alameda as if it did not share offices, managers or digital structures with FTX, refusing to take responsibility for the fraudulent antics of the crypto trading firm.

"Over the course of 2021, Alameda's balance sheet grew to roughly \$100b of Net Asset Value, \$8b of net borrowing (leverage), and \$7b of liquidity on hand," he wrote on Substack. "Alameda failed to sufficiently hedge its market exposure." Bankman-Fried owns 90% of Alameda.

Caroline Ellison, former CEO of Alameda Research, and Gary Wang, co-founder and former chief technology officer of FTX, pled guilty on Dec. 19 to almost identical charges that Bankman-Fried faces: wire fraud, conspiracy to wire fraud and money laundering.[9]

Ellison and Wang detailed their schemes and methods of funneling funds from FTX to Alameda, admitting that they knew it was theft.

The jury will see a harsh contrast between Bankman-Fried's Substack defenses that he did not manage Alameda and was unaware of any fraud activity with that of his co-conspirators' testimony, who said Bankman-Fried knew all about it and participated. Simply put, they all knew, and they all profited from it.[10]

Bankman-Fried also tries to fault a clumsy market

Independent of FTX or Alameda's operations, Bankman-Fried said the crypto market brought down Alameda and then FTX.

In his Substack post, Bankman-Fried stated, "Then, over the course of [2022], markets crash — again and again and again. And Alameda repeatedly fails to sufficiently hedge its position until mid-summer."

"Alameda failed to sufficiently hedge against the risk of an extreme market crash: the hundred billion of assets had only a few billion dollars of hedges," he continued, shifting more blame to Alameda. "Over the course of 2022, a series of large broad market crashes came — in stocks and in crypto — leading to a ~80% decrease in the market value of its assets."

He goes into great detail about his crypto-nomics, but he omitted the list of FTX and Alameda funds to flowing political candidates, as well as the Bahamian real estate villas in one of the exclusive, expensive enclaves in the world for the team and his parents, including at Old Fort Bay, Bayside Executive Park, three condos at One Cable Beach, the Orchid penthouse and the Albany Bahamas Resort.[11]

Defense 2: Zero Ordinary Business Compliance or Governance

Another of Bankman-Fried's defenses appears to be essentially that though FTX had no compliance or governance, it did not employ criminal business practices.

Consider, for example, how he said he has not managed Alameda for years, and that in doing so, he confessed to an aloof management style, as if he ignored all minimal compliance standards and business practices.

"FTX International and Alameda were both legitimately and independently profitable businesses in 2021, each making billions." he wrote in the post. "Alameda became illiquid, FTX International did as well, because Alameda had a margin position open on FTX; and the run on the bank turned that illiquidity into insolvency."

But he later added, "And then Alameda lost about 80 percent of its assets' value over the course of 2022."

But nobody relayed this to Bankman-Fried?

Consider that he attempted to argue that he knew nothing about Alameda's day-to-day operations. No matter that Alameda and FTX's employees lived and worked in the same facilities or that FTX allegedly programmed loan exceptions into its digital platform to open the spigot of funds to flow to Alameda.

Neither FTX nor Alameda had a board of directors. There was no governance, which is unusual for a multibillion-dollar corporation.

Yet, Bankman-Fried also said on Substack, "All of which is to say: no funds were stolen. Alameda lost money due to a market crash it was not adequately hedged for."

He repeated in his leaked written congressional testimony, which was canceled due to his arrest, that he was out and about at high-level crypto events and meetings.

Bankman-Fried said in his planned written testimony that he was away from work about 75% of his time in 2022: "I was less grounded in operational details. ... I was spending, approximately ... 25% of my time talking with regulators and policymakers in DC and beyond, ... 25% of my time on branding ... and 25% of my time managing FTX's growing workforce." He added that he ended up failing to focus on risk management.

The jury will need to dissect witness candor and demeanor, as well as analyze expert charts and testimony that each side will present. Bankman-Fried and the prosecution will each present opposing facts and the jury must decide which side is correct.

The sloppy business practices defense, if supported by sufficient facts, can negate the intent-to-defraud component of wire fraud, conspiracy to commit wire fraud, and theft offenses that have scienter as an element.

Bankman-Fried must convince the jury that he was not part of the scheme or the plan to operate a haphazard crypto platform. But that is a tall order and unlikely, given the details that the government detailed in its indictments and civil complaints.

To prevail, Bankman-Fried must show the jury that Alameda diverted funds from FTX to Alameda without his knowledge or cooperation, that there was no secret back door coded into the FTX platform, that funds were not misappropriated to Alameda without Bankman-Fried's assent and knowledge, and that he was like an absent landlord who did not manage Alameda and FTX day-to-day.

But government filings, quoting FTX and Alameda witnesses, are expected to show otherwise: Wang and Ellison's testimony and admissions of shared blame with Bankman-Fried, as well as the SDNY, SEC and CFTC's documents and financials should wipe clean jury doubts that Bankman-Fried lacked the intent to defraud.[12]

Defense 3: Unaware of Key Corporate Activity and FTX Coding

In support of his assertion that he didn't have an idea of what went on technologically or with specificity, Bankman-Fried said in his written congressional testimony, "In reconstructing the events of 2021-22, I am relying on memory, ... as I was not fully aware of the many critical events at the time they happened and don't have access to the relevant data right now that would allow me to confirm or disconfirm my best guess at this point. In particular, I was not running Alameda Research this past year."

In a Nov. 16 interview that was posted on YouTube 13 days later, his first after FTX's

collapse, Bankman-Fried denied culpability for coding the Alameda exemption onto the FTX platform.

"So that I can tell you it is definitely not true," he said. "I don't even know how to code. It's the honest, embarrassing answer. I certainly wasn't building some back door in this system. I could barely use the system." [13]

Yet, if prosecutors present evidence that he directed the coding exemption, this argument is likely to fail.

Bankman-Fried could attempt to present the argument that the FTX coding exemption was a digital glitch, combined with his assertion that the market crisis and Alameda's overly leveraged position caused FTX's value to disintegrate.

In his Substack post, Bankman-Fried asserted that he did not work at Alameda, meaning his argument that he didn't control the systems there tracks with his claim that he was innocent.

But Wang admitted already that Bankman-Fried told him to code an exemption, the back door, for FTX, so it seems impossible for Bankman-Fried to prove that the FTX coding exemption was a digital glitch and that he was not complicit.

And Wang's testimony is going to mirror Ellison's testimony, just like their guilty plea admissions.

Ellison also testified that Bankman-Fried orchestrated the coded exemptions that allowed Alameda to be exempted from debt recalls. The SEC's complaint said, "Bankman-Fried directed investment and operational decisions, frequently communicated with Alameda employees, and had full access to Alameda's records and databases." [14]

Meanwhile, the CFTC complaint states that "Bankman-Fried operated [defendant entities] as a single, integrated common enterprise under the sole ultimate authority of Bankman-Fried as their mutual owner." [15]

The newly appointed CEO of FTX, John J. Ray III, also testified to Congress that there were no walls or divisions between the two companies.

Bankman-Fried could attack Ellison's veracity and show that she lied.

The CFTC complaint describes exemptions and privileges that FTX granted to Alameda, [16] and Ellison confessed to the group that her Nov. 9 tweet to Binance that she would buy back FTT tokens at \$22.00 was not truthful. [17] If Bankman-Fried can convince the jury that as a result, Ellison is not a credible witness, then the jury can discredit her testimony completely, and he could defeat some of the prosecution's indictment counts.

Bankruptcy Protection

The bankruptcy proceedings will expose Bankman-Fried's purported misdeeds further.

In his Substack post, Bankman-Fried maintained that he was strong-armed into signing the Chapter 11 bankruptcy petition. He accused the law firm Sullivan & Cromwell of threatening him to file and to choose a bankruptcy manager candidate.

On Jan. 8, 2023, the debtors advised the court that because the list of bankruptcy debtors was too long to be attached to the Delaware bankruptcy court, they set up a website to list the debtors.[18] The list was that long.

Referring to the bankruptcy proceeding, Bankman-Fried said on Substack, "There were billions of dollars of funding offers when Mr. Ray took over, and more than \$4b that came in after."

Even though Bankman-Fried claims to want to solve the problem and that he is blameless, once the jury hears testimony about disappearing billions of dollars, a lack of risk management, no board of directors and no separation between FTX and Alameda, the jury will likely reject Bankman-Fried's claim.

Bail Conditions Dispute Ongoing

Bankman-Fried did not silence himself after the Substack post. He contacted potential prosecution witnesses, including current FTX CEO Ray, which Bankman-Fried mentioned in his Substack post.

On Jan. 27, federal prosecutors expressed alarm in a letter to the U.S. District Judge Lewis A. Kaplan of the SDNY and asked for two bail modifications for Bankman-Fried. One was to restrict Bankman-Fried from contacting prospective witnesses, FTX or Alameda employees without counsel, while the second would forbid Bankman-Fried's use of ephemeral or encrypted messaging.

In a response letter, the defense argued against those modifications and requested the court to remove Bankman-Fried's condition that he may not enter crypto platforms.

The U.S. attorneys argued to the judge that these messages could obstruct justice or tamper with witnesses, many of whom are victims of this alleged fraud. The court's scheduling order provides for replies to be filed by Feb. 2.

The court also ruled that the individuals who posted bail for Bankman-Fried could be unsealed.

Guilty Verdict Predicted

In sum, Bankman-Fried's wobbly defenses will likely fail against prosecutors' forensic evidence.

Although Bankman-Fried argued that FTX has available funds and that he had no oversight of Alameda, the prosecution can be expected to build a wall of FTX financial reports with supporting witnesses to show that he committed fraud by ordering the misfeasance and fraud.

At trial, the prosecution can be expected to present detailed forensic evidence to show that Bankman-Fried directed Wang to create the coded hole so that Alameda could pull funds from FTX.

In his Substack post, Bankman-Fried referred to FTX auditor reports, showing a strong, healthy balance sheet. But the prosecution will rebut his claims with evidence of the theft of customer and lender funds, and they are able to trace every crypto coin conversation and digital movement.

"I didn't steal funds, and I certainly didn't stash billions away," he also wrote in the post. "Nearly all of my assets were and still are utilizable to backstop FTX customers."

When the forensics are completed, the charts fill the courtroom and the experts and witnesses take the stand, the jury will likely see Bankman-Fried's intent to commit fraud.

The jury could get bleary-eyed with all the charts, but the FTX and Alameda witness testimony from prior employees, plus the government's financial forensic evidence, will likely lead the jury toward a verdict of guilt.

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[1] <https://sambf.substack.com/p/ftx-pre-mortem-overview>. Author "SBF" FTX Pre-Mortem Overview. Last accessed January 22, 2023.

[2] Conspiracy to Commit Wire Fraud on Customers, Wire Fraud on Customers, Conspiracy to Commit Wire Fraud on Lenders, Wire Fraud on Lenders, Conspiracy to Commit Commodities Fraud, Conspiracy to Commit Securities Fraud, Conspiracy to Commit Money Laundering, and Conspiracy to Defraud the United States and Violate the Campaign Finance Laws. U.S. District Court SDNY, Indictment, 22 Crim. (2022), U.S.A. v. Samuel Bankman-Fried aka "SBF."

[3] Commodities Future Trading Commission. Press release Number 8638-22, "CFTC Charges Sam Bankman-Fried, FTX Trading and Alameda with Fraud and Material Misrepresentations." December 13, 2022. CFTC Amended complaint, Case No. 1:22-cv-10503-PKC, CFTC v. Samuel Bankman-Fried, FTX Trading Ltd., d/b/a/ FTX.com, Alameda Research LLC, Caroline Ellison and Zixiao "Gary" Wang (December 21, 2022).

[4] In court testimony, Dietderich described the Alameda unlimited credit, "And we know the size of that line of credit. It was \$65 billion."

[5] <https://cointelegraph.com/news/alameda-research-had-a-65b-secret-line-of-credit-with-ftx-report>, quoting New York Post, author Ariel Zilber, "Sam Bankman-Fried ordered \$65B 'secret backdoor line of credit,'" January 13, 2023.

[6] Securities and Exchange Commission, Press release 2022-218, "SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX." December 13, 2022.

[7] <https://sambf.substack.com/p/ftx-pre-mortem-overview>.

[8] Twitter, author Samuel Bankman-Fried, November 10, 2023.

[9] United States Attorney Announces Extradition Of FTX Founder Samuel Bankman-Fried To The United States And Guilty Pleas Of Former CEO Of Alameda Research And Former Chief Technology Officer Of FTX. Press release 22-407, December 22, 2022.

[10] FBI Assistant Director Michael J. Driscoll said: "With the pleas announced today, Ms. Ellison and Mr. Wang admitted they were willing participants in schemes to defraud FTX.com's customers and backers out of their money.

[11] Financial post/video, "FTX Spent Millions on a Lavish Lifestyle, SBF and Caroline Ellison, by Diamond Hands Investing, Market News, Stocks, Crypto, Finance. January 16, 2023.

[12] A simple sample. The CFTC complaint paragraph 107. Page 31. Ellison held a meeting at Alameda She told the group that, "Alameda was 'borrowing a bunch of money by open term loans' and used those assets to 'make very illiquid investments.'" Ellison also said that most of Alameda's loan's had been recalled and the FTX funds were needed to satisfy those loans, but it caused FTX to suffer a shortfall.

[13] "Sam Bankman-Fried's First Interview After Collapse," Tiffany Fong, November 29, 2022, interview YouTube, <https://www.youtube.com/watch?v=6DezodR9hNI>.

[14] See paragraph 18 in the SEC complaint.

[15] CFTC complaint, paragraph four (4).

[16] CFTC complaint paragraph six (6).

[17] CFTC complaint paragraph 107. Page 31.

[18] <https://restructuring.ra.kroll.com/FTX/Home-Index%20673>.