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Best Text Practices In Light Of Terraform's $4.5B Fraud Deal

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Text messages and other non-email, electronic communications have become increasingly important in securities fraud matters. These communications are often sent from personal mobile devices and often provide key evidence. It has become clear that the most interesting — and sometimes most problematic — communications often do not take place via email.

Since 2021, the U.S. Securities and Exchange Commission has investigated large trading firms for so-called off-channel communications, business-related communications through platforms that are not monitored or firm-approved, e.g., text messages. As a result, the SEC has fined financial firms a total of over $1.7 billion for failure to maintain and preserve electronic communications.[1]

Following a civil trial in April, now-bankrupt Terraform Labs agreed to a $4.47 billion settlement in June to resolve an SEC lawsuit, after Do Kwon, its co-founder, was found liable of fraud. This settlement will be treated as an unsecured claim in Terraform's Chapter 11 case.[2]

At trial, the SEC offered into evidence text messages among employees that detailed a secret arrangement between Terraform and Jump, a crypto trading platform, to prop up Terraform's cryptocurrency before it collapsed. These text messages included a message from Terraform's head of communications stating that Kwon "said if Jump hadn't stepped in we actually might've been fucked." The business development head responded, "I know they saved our ass."[3]

After a discussion with the crypto trading platform, the communications head texted "Spoke with Do [Kwan], we're gonna deploy $250 million from stability reserve through Jump to stabilize the peg." He followed up with, "Jump has already started buying … May not need entire $250 million."

The next day, Terraform's official Twitter account posted "Terra's not going anywhere … $1 parity on UST already recovered."

This is just one example of a case where the preservation, collection and production of text messages were critical to its outcome.

There are at least three areas where companies should examine their internal policies concerning

mobile device data: (1) policies and procedures for mobile device use and off-channel communications; (2) preservation and collection obligations regarding employee communications on mobile devices, including personal devices, in litigation; and (3) content of mobile messages that will be produced in litigation.

Policies and Procedures

Internal policies governing the use of mobile devices and any off-channel communications should be in place and discussed with employees as a critical part of onboarding, as well as during ongoing human resources conversations.

Business-related communications via messaging applications that are not monitored or maintained by their employers have dramatically increased since the beginning of the COVID-19 pandemic. For those working in financial services, including investment bankers and securities traders, the existence of communications about firm business on messaging applications like iMessage, WhatsApp, Slack, or Signal risks scrutiny and fines from government regulators.

Additionally, employees at financial firms may be more likely to send problematic or even illegal messages through unmonitored channels if they believe the messages will not be subject to scrutiny, particularly on their personal devices. These messages may give rise to civil liability for both regulators and private plaintiffs.

When developing a mobile device policy, companies should consider the following questions.

Whether employees use company-issued devices or not, is there a policy for employees who bring their own devices?

Many employees prefer to use a single device for both personal and work-related purposes, even when a corporate device is offered. They should, however, be informed of the risks of intermingling business and personal communications, particularly if their good friends are also business contacts.

U.S. v. Blaszczak, a case decided by the U.S. Court of Appeals for the Second Circuit last year, involved a Centers for Medicare and Medicaid Services employee who had remained friends with David Blaszczak, the defendant, after he left the organization to work for a hedge fund.[4] The employee provided inside information via their phone calls, emails and text messages on CMS rate changes that lowered reimbursement rates.

Are employees required to cooperate with requests for access to their devices during litigation?

This consideration underscores the requirement for a bring-your-own-device policy or corporate device policy. Either of these policies should specifically articulate the requirement of providing access to business-related communications, documents, photographs and other data stored on mobile devices in case of litigation.

Policies should also discuss an employee's expectation of privacy with respect to the personal data on a device that is used for business purposes. This will also help employees make informed decisions about how and when to communicate on a mobile device for work purposes before the information is discoverable.

How are the mobile device policies enforced? Which applications are employees allowed to use for work purposes?

It is important to consider mobile device management and mobile device data-archiving tools, and other corporate access to mobile devices that will be used for business purposes. The software can allow companies to remotely monitor, update, secure, and even delete data from personal smartphones or tablets that are used for business purposes. Employers can designate applications for business use.

As an example, Microsoft Office 365 provides a full suite of applications, including Outlook, Teams, and applications to view and edit documents. These and other similar applications can be protected by passwords and/or two-factor authentication.

Importantly, data from applications designed for corporate use can also be stored on a company server.

What are the policies and procedures for departing employees?

If the departing employee used a corporate device, internal policies should require the employer's IT department to verify whether there is an obligation to preserve the data on the device before it is erased. If the departing employee used a personal device, the company should collect any data that may be relevant to an ongoing or foreseeable litigation.

If it is not possible to collect the data prior to the employee's departure, the employee should be reminded of the potential obligation.

Preservation and Collection

In litigation, companies are required to produce data that is within their possession, custody and control.

As part of this determination, courts will consider the following factors when it comes to mobile data: (1) whether the employer issued the devices, (2) how frequently the devices were used for business purposes, (3) whether the employer had a legal right to obtain communications from the devices, and (4) whether company policies address access to communications on personal devices.[5]

Here are some considerations related to the preservation and collection of mobile data.

What communications may be relevant?

Any employee who may possess information relevant to the litigation may also possess relevant mobile data. Counsel, along with forensic examiners, will often interview employees who likely have information relevant to the litigation to identify the type and frequency of business communications, applications used for business purposes, and the amount of potentially relevant information the employee possesses on their mobile device.

Other details may help focus the text message collection, including the relevant time periods of the conversation, e.g., the time periods surrounding a particular trade or release of information; the communication platforms used, e.g., iMessage, WhatsApp or Signal; and the parties of interest.

In U.S. v. Buyer, before the U.S. District Court for the Southern District of New York in 2023, the

defendant, former U.S. Rep. Stephen Buyer, was **convicted** of trading on inside information related to a proposed acquisition of Navigant by Guidehouse.[6] He admitted to phone calls and text exchanges with a Guidehouse employee right before he purchased Navigant stock.

The government also presented a Signal message from the defendant as evidence of an attempted cover-up. The message read: "I need to see you. Please … I will catch next flight. I was interviewed and told them I bought." The defendant had intended for this message to be deleted after five minutes.

What is the level of technical sophistication of the employees?

Data may be inadvertently lost in a number of ways, including a failure to follow a litigation hold; accidental deletion of messages, e.g., auto-delete; upgrading the device to a different model without transferring or backing up its data; or performing a factory reset. It is important to assess whether to trust an employee to properly manage their device settings, or whether it may be necessary to preemptively collect mobile data to ensure that it is preserved.

It is important to be aware of the default settings in place before a litigation hold is in effect, both on mobile devices and corporate servers, as these settings may need to be adjusted. Mobile device management systems and applications backed up to a remote server, e.g., Microsoft Outlook and Teams, make it easier to preserve data at a global level and eliminate user error.

If an employee uses text messages or other messaging apps to communicate for business purposes, it will be important to instruct the employee to change their device settings to ensure that no information will be inadvertently deleted, particularly because courts will likely consider business communications to be within the employer's control.

Although proper preservation of mobile data often does not require a substantial effort, a failure to adequately preserve relevant mobile data can result in monetary sanctions and/or adverse inferences at trial.

In Hunters Capital LLC v. City of Seattle, the Seattle mayor deleted thousands of text messages from her employer-owned phone, claiming that this was partly because she inadvertently set all text messages to auto-delete after 30 days.[7] The U.S. District Court for the Western District of Washington in 2023 issued an adverse inference instruction to the jury, telling them they could presume that the text messages were unfavorable to the defendant.

What are the technical requirements and procedures for collection?

The collection process can often be performed remotely, but the forensic examiner will sometimes require physical possession of the device. If the mobile data in question is backed up on a remote server, it can be collected remotely, and with minimal disruption to the employee.

Apple iPhone data can typically be collected remotely through iCloud, while Android data typically must be collected from the device itself. Messages and other data from mobile devices that are not available on a remote server are typically collected through a logical extraction, which creates a forensic image of the entire phone, preserving the integrity of the data at the time of the collection.

Importantly, however, logical extraction cannot recover deleted files or be used on a locked device. Ephemeral messaging applications, e.g., Signal and Telegram, which do not permit archiving or remote

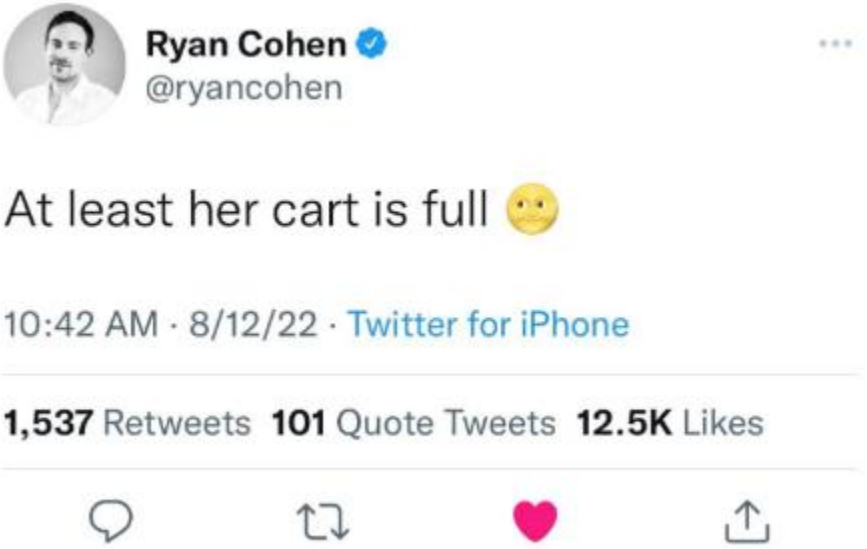
storage of messages, can only be collected through screenshots or manual collection methods. Additionally, if an employee has very few relevant messages, a screenshot or other manual collection may be appropriate.

Content of Mobile Messages

In litigation, as opposed to regulatory investigations, the parties may have more room to negotiate the scope and relevancy of mobile messages to be produced to the other side. The legal team can opt to produce only the relevant portions of message threads, redacting nonrelevant messages and images — including personal messages and photos.

In some instances, however, it may be necessary to produce nonrelevant messages to provide context.[8] Additionally, one-off messages, gifs or emojis can sometimes provide important evidence if they are understood to have a certain meaning in the relevant industry-specific communications.

For example, in In re: Bed Bath & Beyond Corp. Securities Litigation, the U.S. District Court for the District of Columbia in 2023 found that a message with an emoji provided potentially key evidence of securities fraud.[9]



In denying a motion to dismiss, the court noted: "Some online communities understand the smiley moon emoji to mean 'to the moon' or 'take it to the moon.' … In other words, according to Plaintiff, Cohen was telling his hundreds of thousands of followers that Bed Bath's stock was going up and that they should buy or hold. They did so, sending the price soaring."

Similarly, in Friel v. Dapper Labs Inc., for example, the Southern District of New York **reasoned** last year that "the 'rocket ship' emoji, 'stock chart' emoji, and 'money bags' emoji objectively mean one thing: a financial return on investment."[10]

Even metadata can contain damaging information, as in the case of the now-defunct cryptocurrency exchange FTX, where Sam Bankman-Fried and other staff had a Signal chat group named "Wirefraud."[11]

Final Considerations

Given the proliferation of these communications and their probative value in the cases discussed above, it is undeniable that litigants in securities fraud cases need to have robust mobile data policies that address the content and retention of messages, applications used for messaging, and the obligations of employees to allow for collection, in addition to an IT infrastructure that facilitates all of the processes outlined above.

It is also important to ensure that employees understand the risks of communicating about business on a personal device, as well as the discovery obligations related to those communications.

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[1] https://www.reuters.com/legal/government/sec-sued-by-trade-association-details-record-keeping-probe-2024-06-06/.

[2] https://www.reuters.com/legal/crypto-firm-terraform-labs-agrees-pay-447-bln-resolve-dispute-with-sec-2024-06-12/.

[3] SEC v. Terraform Labs PTE LTD, 23-cv-1346 (JSR) (July 31, 2023).

[4] 947 F.3d 19 (2d Cir. 2019).

[5] See, e.g.,Miramontes v. Peraton, Inc., No. 3:21-CV-3019-B, 2023 WL 3855603 (N.D. Tex. June 6, 2023).

[6] 22 CR. 397 (RMB) (S.D.N.Y. Mar. 14, 2023).

[7] 2023 WL 184208 (W.D. Wash. Jan. 13, 2023).

[8] See Al Thani v. Hanke, No. 20 CIV. 4765 (JPC), 2022 WL 1684271, at *2 (S.D.N.Y. May 26, 2022) ("a single text message, standing alone, is oftentimes meaningless without other messages in the text chain to provide context").

[9] U.S. Dist. LEXIS 129613 (D.D.C. July 27, 2023).

[10] No. 21-cv-5837, 2023 WL 2162747, at *17 (S.D.N.Y. Feb. 22, 2023).

[11] https://www.theguardian.com/business/2022/dec/13/sam-bankman-fried-ftx-signal-wirefraud-chat-alameda.