SEC accuses engineer for Baton Rouge's Game Coin of 'rug pull'

By **Dillon Lowe**

Eric Zhu, an out-of-state blockchain engineer, has agreed to pay over $800,000 after the Securities and Exchange Commission accused him of engaging in a scheme to defraud investors in Game Coin, a cryptocurrency asset offered and sold as a security predominantly to investors residing in or around Baton Rouge.

Game Coin was launched in 2021 by Baton Rouge entrepreneurs Frankie Badeaux and David Mahler, who are not named in the SEC's lawsuit against Zhu. The startup aimed to allow amateur athletes to create their own digital trading cards which could then be bought and sold on a web-based marketplace using its Game Coin—or GME—token.

The company garnered local attention upon its launch by offering investors the chance to profit off of up-and-coming athletes and by partnering with some such athletes, including LSU football players, through name, image and likeness deals.

Today, Game Coin serves as the official utility of OnFire Athletes, an online platform that allows users to create, buy and sell digital sports cards.

According to documents filed in Baton Rouge federal court on Jan. 16, Zhu lives in New York and was hired by Game Coin to perform coding work. His duties gave him control over certain aspects of GME's liquidity pool. The SEC alleges that Zhu, from approximately June 2021 through at least September 2021, exploited that control to deceive investors and ultimately commit a "rug pull," violating multiple antifraud provisions of federal securities laws.

In a statement provided to *Daily Report*, attorney Roy Maughan says Game Coin has been cooperating with the SEC's investigation for the past three years and "supports the government's efforts to bring Mr. Zhu to justice."

How do liquidity pools work?

Liquidity pools allow investors to buy and sell crypto assets on decentralized exchanges, eliminating the need for traditional intermediaries. As the name suggests, liquidity pools require liquidity (deposited crypto asset pairs available for trading).

In the case of Game Coin, deposits of GME and Binance Coin—or BNB—served as the initial liquidity for the GME liquidity pool. Investors could, for example, buy GME and deposit BNB, or sell GME and withdraw BNB. The value of GME at any given time was determined by the ratio of GME to BNB in the liquidity pool. As investors purchased GME using BNB, the supply of GME within the liquidity pool decreased and the value of GME increased.

A person who deposits a crypto asset token pair (liquidity) into a liquidity pool receives "liquidity provider" tokens—or LP tokens—which, absent safeguards, allow their holder to withdraw a pro rata share of the liquidity deposited into the liquidity pool. Such liquidity pools create certain risks for investors, including the risk that the holder of a significant amount of LP tokens may withdraw a large portion of the token pair from the liquidity pool without warning. The token holder may then sell (deposit) large volumes of one of the crypto assets in question into the liquidity pool, significantly diminishing the value of that asset.

A significant withdrawal of liquidity and the corresponding sale of a crypto asset is often referred to as a "rug pull" because the seller is, in essence, pulling the rug out from under the investors who purchased assets through the liquidity pool at hand.

Aware of that risk, Game Coin leadership assured investors in publicly available social media posts that liquidity was "locked," documents show, conveying that LP tokens could not be used by their issuers or other insiders to commit a rug pull.

What exactly is Zhu accused of doing?

The SEC alleges that certain LP tokens accrued to an address that Zhu alone controlled. Unbeknownst to anyone, he kept those LP tokens unlocked and used them to withdraw GME and BNB from the GME liquidity pool. He then sold the withdrawn GME into the liquidity pool and misappropriated crypto assets worth approximately $553,000. His sale caused the price of GME to decline by approximately 12%, causing investor panic.

Zhu's conduct violated multiple antifraud provisions of federal securities laws, according to the SEC.

Noting that Zhu worked for one of Game Coin's contractors in 2021, Maughan says the company only recently learned of his identity and the extent of his involvement.

"In 2021, when Game Coin became aware of unexpected activity on the blockchain, it took immediate action to protect token holders," the attorney says. "In 2021, when Game Coin represented that the GME liquidity was 'locked,' it did not know, and could not have known at the time, that Mr. Zhu had programmed an unauthorized back door in the software."

According to a proposed final judgment from the SEC filed Jan. 17, Zhu has consented to a permanent injunction enjoining him from further violating federal securities laws and has agreed to pay the SEC $822,992, a total that accounts for his ill-gotten gains, civil penalties and prejudgment interest. He has not admitted to or denied the allegations brought against him.

The proposed final judgment now awaits Judge John deGravelles' signature.

Editor's Note: *This article has been updated since its original publication to include a statement from Game Coin.*

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