

How To Get Your Crypto Currency Offering Enjoined

Crypto currency has been all the fashion. Most proponents that have been confronted by a regulator – the SEC or CFTC generally – have quickly resolved the matter. Few have tried to litigate with the agencies and those who have tried typically have not prevailed. The sole exception may be Blockvest, LLC and its owner, Reginald Buddy Ringgold, III – but not for long. True the district court initially refused to grant a preliminary injunction after entering a temporary freeze order. True the court cited conflicting facts and incomplete discovery. True Defendants admitted mistakes but claimed that nothing had really happened with their ICO despite obvious and repeated false statements on their website – the same position they took earlier. In the end, however, the court reversed its earlier determination and entered the injunction – but only after defense counsels' motion to withdraw citing Rule 11 and Defendants' failed effort to file the Rule 11 documents at the center of the withdrawal motion. *SEC v. Blockvest LLC*, Civil Action No. 18-cv-2287 (S.D. Cal. Opinion Feb. 14, 2019).

Background

The Commission filed a complaint alleging Defendants violated Securities Act Sections 5(a), 5(c) and 17(a) and Exchange Act Section 10(b). The complaint alleged that Defendants were engaged in the illegal distribution of securities through an Initial Coin Offering using a White Paper and a website. Specifically, Defendants began a pre-sale of BLV coins in March 2018. The White Paper listed stages for the offering: 1) A private sale with a 50% bonus that would run through the end of April 2018; 2) a pre-sale with a 20% bonus that would begin on July 1, 2018 and continue until early October; and 3) a \$100 million ICO that would begin on December 1, 2018.

The website claimed that the offering had been registered and approved by the SEC. The agency seal was on the Blockvest website. The website also stated that the offering had been approved and endorsed by the CFTC and the National Futures Association. The logo and seal of those entities appeared on the Blockvest website. The website stated that Defendants were partnered with, and audited by, Deloitte Touche Tohmatsu

Related Capabilities

- Securities & Financial Services Litigation & Enforcement

Limited. The website also listed the Blockchain Exchange Commission and displayed its seal which is largely identical to that of the SEC. The address listed for that agency is the same as that of the SEC's Headquarters Office in Washington, D.C. Each of these representations is false, according to the SEC.

Defendants claim that Bockvest never sold any tokens to the public, although they did make mistakes. No tokens were ever released by the firm to the participants referenced on the website. To the contrary, the plan was to test a new utility Token BLVX on the NEM Blockchain for exclusive use on the BlockVest Exchange. No money was received from investors, only \$175,000 from Mr. Ringgold.

Mr. Ringgold testified in deposition that he knew the identity of the 32 investors the website claims acquired coins. They were supposedly vetted to create a test group. The cash involved here, aside from that of Mr. Ringgold, is from his friends and family who put up money because they trusted him. Declarations were submitted by nine individuals stating that they did not purchase tokens or rely on the representations the SEC claims are false. Other investors did, however, write "Blockvest" and/or "coins" on their checks. There is no fraud, no purchase, no sale of a security, according to Defendants.

Opinion

The case was before the court on the SEC's motion for reconsideration of the earlier refusal to enter a preliminary injunction. The critical questions for consideration now that discovery had been completed are whether a security is involved and if there is a likelihood of a reoccurrence of the wrongful conduct counseling the entry of the requested injunction. The court answered each question in the affirmative.

First, there is a security. The seminal case is *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The three part test established by the High Court requires a determination of: 1) If there was an investment of money; 2) whether those funds were put into a common enterprise; and 3) if there is an expectation of profits from the efforts of others.

While initially the court denied the SEC's request for a preliminary injunction, that ruling was based on the significant fact disputes that appeared at the threshold of the litigation. Here the SEC focused on "the promotional materials presented on Defendants' website, the Whitepaper posted online and social media accounts concerning the ICO of the BLV token [which] constitute and 'offer' of unregistered. . ." securities in violation of Section 17(a). Those materials show that Defendants sought to entice potential investors to purchase BLV tokens by using the "Buy Now" button on the website -- the first *Howey* factor.

Equally clear is the fact that the investment was in a "common enterprise" within the meaning of the Supreme Court's seminal decision. Blockvest claimed that the funds would be pooled and there would be a profit sharing formula -- the second *Howey* factor. Finally, the website told investors they would be "passive" -- profits would come from the activities of others, the final *Howey* factor. Accordingly, it is clear that a security is involved.

Finally, the court concluded that an injunction should be entered since there is a reasonable likelihood that the wrong will be repeated. One of the key factors here is the state of mind of the Defendants which requires an analysis of the prior violations and the potential for repetition in the future. While Defendants admit mistakes and argue again as they did earlier that there is no need for an injunction, that claim is not supported by the record. There are past violations as demonstrated by the fact that unregistered securities were offered for sale.

Perhaps more importantly, there is the potential for repetition in the future. That arises not just by inference from the prior violations but in view of the recent actions of defense counsel and Defendants. Defense counsel requested leave to withdraw because of a request to file certain documents which they could not assert complied with Rule 11. Subsequently, Defendants sought to file the same documents. The clerk of the court rejected the request. In view of these facts, and the complete discovery record, the court granted the Commission's request for reconsideration and entered a preliminary injunction.

Comment

The court's initial denial of the SEC's request was viewed by many as a significant loss for the agency. Throughout its opinion on the motion for reconsideration the court revisited that determination. The legal issues and much of the evidence is the same in each instance. For example, the false claims that littered Defendants' website about the SEC, CFTC, NFA and the wholly made-up Blockchain Regulatory Agency continued to be on full display. Defendants' oft repeated claims which essentially argue "no harm no foul" based on the supposition that "mistakes were made" but there were no investors, just Defendants' money and that of friends were the same yarns spun at the earlier hearing.

While discovery is now complete, and more facts were available, the determinative factor seems to have been the withdrawal of defense counsel and the efforts to file documents that failed to comply with Rule 11. Indeed, the real difference here seems to have been not the facts but the loss of credibility by Defendants – the veracity of their denials appears to have collapsed in the wake of defense counsel's withdrawal and their misguided effort to file documents that could not pass muster under Rule 11. Credibility is everything.