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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

BLOCKVEST, LLC and REGINALD BUDDY RINGGOLD, III a/k/a RASOOL ABDUL RAHIM EL,

Defendants.

Case No. 18-cv-2287 GPC(MSB)

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S REPLY IN SUPPORT OF MOTION FOR PARTIAL RECONSIDERATION OF ORDER DENYING PRELIMINARY INJUNCTION (Dkt. No. 41)

Date: February 8, 2019
Time: 1:30 p.m.
Ctrm.: 2D
Judge: Hon. Gonzalo P. Curiel

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I. INTRODUCTION

The Securities and Exchange Commission ("SEC") moved, on two separate grounds, for partial reconsideration of the Court's order (Dkt. No. 41) (the "Opinion") denying the SEC's application for a preliminary injunction against future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"). First, the SEC respectfully contends that the record establishes that defendants' token was a security. In holding to the contrary, the Opinion appeared to have focused solely on the subjective evidence of particular purchasers' experiences and thus erroneously overlooked the objective terms of the investment that defendants publicly advertised. *See* Dkt. No. 44 ("Mot.") at 15-23. As the Ninth Circuit has made clear, determining whether or not an investment is a security under *SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946) is an "objective inquiry" that requires courts to consider the nature and terms of the investment defendants promoted to the public—and not just what individual investors may or may not have thought.

Defendants' opposition brief wholly ignores this point. Instead of addressing the Ninth Circuit's "objective inquiry" mandate, defendants just argue that the Court's focus on the experiences of some of the purchasers was sufficient. *See* Dkt. No. 53 ("Opp.") at 5. But this ignores what was, objectively, offered to the public at large. Defendants did not, and still do not, dispute that the BLV was presented publicly as an offering of an investment of money or other currency in a digital token that could produce a "passive" profit. Indeed, that is the very reason why defendants lied about the offering being registered and approved by the SEC. Instead of responding to the Ninth Circuit and Supreme Court precedents that require an objective *Howey* inquiry, defendants cite state contract law to argue about whether they ever made an "offer" of that security (*id.* at 6-7, 8-10), and dispute that they acted with scienter (*id.* at 10-12). If the Court agrees with the SEC on the threshold question that the token was a security, these remaining elements of Section 17(a) are satisfied.

Second, the SEC's reconsideration motion asserts that under Ninth Circuit precedent, defendants' promises to stop making egregious lies in their offering—once they retained counsel—should not dispose of the need for a preliminary injunction. *See* Mot. at 23-25. In opposition, defendants argue that the "unblemished record of their conduct after the Court's Order" has only "proven the Court to be correct." Opp. at 4-5. But the Court should reevaluate whether adequate safeguards are in place to protect the investing public. There is no indication that the presence of counsel has corrected defendants' penchant for misstatements. To the contrary, Ringgold instructed his counsel to "make filings with the Court that are not consistent with [counsel's] ethical duties and Rule 11" and "even attempted to file such documents with this Court without [counsel's] permission or signature." Dkt. No. 47-1, ¶¶ 8-9; Dkt. No. 47 at 8 (reporting that defendants "have maliciously attacked" counsel).

This conduct is highly relevant to the SEC's motion. The Opinion specifically cited the role of defendants' "securities compliance counsel" as a reason for the Court, in lieu of an injunction, to rely on Ringgold's promises that defendants would not resume their illegal conduct. But Ringgold has now "levied serious ethical accusations" against his own counsel. *Id.* Moreover, Ringgold's conduct warrants an injunction even if he had no issues with his counsel. Now, more than ever, the importance of an injunction under Section 17(a) is clear.

II. THE BLV TOKEN DEFENDANTS ADVERTISED PUBLICLY WAS A SECURITY IN THE FORM OF AN INVESTMENT CONTRACT

The SEC's reconsideration motion sets forth why, considering "only uncontested facts" (Mot. at 9), the BLV token is a security under the Ninth Circuit's "objective" *Howey* inquiry. *See Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009). The SEC's motion further explains how requiring the SEC to make a subjective *Howey* showing with proof of actual purchasers and what they

individually relied on—as the Opinion appears to have done—would contravene the very purpose of the Securities Act to regulate not only sales, but also offers of securities. Such a requirement would also undermine decades of caselaw holding that the SEC, unlike a private plaintiff, need not prove reliance.

Defendants' opposition does not really address these points, which are fundamental to the SEC's motion. Their opposition does not argue that the *Howey* inquiry is supposed to be subjective, not objective. Nor do defendants dispute the objective facts on which the SEC relies to establish the existence of a security. Rather, defendants merely conclude that the Court's focus on what individual investors saw or did was correct. Opp. at 6-7.[1]

But in doing so, defendants concede three key sets of facts that establish that the BLV token was a security under an objective *Howey* inquiry. *Compare* Mot. at 9-12 *with* Opp. at 6-7. First, it remains uncontested that defendants' Form D identified the offering as a securities offering, with BLV tokens as the "securities offered;" that Ringgold publicly described it as a securities offering; and that Blockvest's whitepaper and website invoked Regulation A in describing it as a securities offering open to unaccredited investors globally. Second, defendants agree that they advertised the offering to the public on Blockvest's website and on social media, including with a "Buy Now" button, which was used to record putative investors' expressions of interest for the planned ICO launch. Third, defendants still do not dispute that they promoted the offering as a means of funding Blockvest's intended products, with an opportunity for passive "digidends" dependent solely on management's efforts. *Id.*

[1] On this point and others, defendants' opposition brief is riddled with references to supplemental evidence that the Court excluded. Defendants repeatedly cite Ringgold's declaration in support of defendants' *ex parte* application for an evidentiary hearing. *See* Opp. at 6, 7, 9, 11, 12, citing Dkt. No. 32. However, because the Court denied defendants' request for leave to file these supplemental documents, they are not part of the record. *See* Dkt. No. 41 at 17. The Court therefore should not consider this evidence on this motion.

All of these facts are highly relevant to an objective *Howey* analysis, since they show how the BLV offering and its terms were advertised to the public at large. Yet defendants ignore all of this. Instead they discuss only the "test investors" and the "investors in Rosegold." Opp. at 7. But as the SEC made clear in its motion, the record of what the "32 test investors reviewed" or what they "relied on," or what the Rosegold investors "rel[ied] on" (Dkt. No. 44 at 13-14), cannot be the only facts considered under *Howey*.

Application of the *Howey* test to the uncontested terms of defendants' publicly promoted investment shows that their offering plainly meets the definition of a security. Defendants called their investment a "securities offering;" they invited people to invest money or currency; and their offering was designed to fund future product offerings and provide passive returns based on management's purported skills and experience. To the extent that the Opinion did not analyze defendants' BLV tokens as offered to the public at large, the SEC respectfully submits that it erred. Based on the objective, undisputed terms of the investment defendants promoted to the public, the offering satisfies all of the *Howey* prongs, including an investment of money, in a common enterprise, with an expectation of profits from the efforts of others. Therefore, the BLV token offering was an offering of securities.

III. THE SEC MADE A *PRIMA FACIE* SHOWING AS TO THE OTHER ELEMENTS OF ITS SECTION 17(A) CLAIMS

Defendants' opposition fails to squarely address this straightforward application of the objective *Howey* test to the question of whether their BLV tokens were securities, which the Opinion appears to have omitted. Instead, defendants seek to revisit other elements of the SEC's *prima facie* showing under Section 17(a), namely whether defendants ever made an "offer" of this security,

and whether they did so with scienter or at least negligence. Opp. at 8-12.[2] As a threshold matter, according to the Opinion, defendants "solely challenge[d] the SEC's claims arguing that the test BLV tokens are not 'securities' as defined under the federal securities law" and did "not dispute the other elements for alleged violations" of Section 17(a) (Dkt. 41 at 8-9); therefore, these elements are not at issue. But if they were, the undisputed record establishes both of these elements.

A. Defendants Offered Their Security to the Public

Defendants argue that they did not "offer" BLVs to the public (despite the "Buy Now" button on Blockvest's website through which defendants recorded investors' expressions of interest), because "there was never a manifestation of intent to be bound" and defendants made "no request for bids." Opp. at 9. For the definition of an "offer," defendants cite a non-securities California contract law case, *Carver v. Teitsworth*, 1 Cal.App.4th 845, 851 (1991). *Id.* at 7. But the definition of an "offer" under the California Civil Code is irrelevant here.

Rather, as the SEC's motion notes, the definition of an "offer" under the Securities Act is a matter of federal statute. An "offer" or an "offer to sell" is defined broadly and includes "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(a)(3). "The term 'offer' has a different and far broader meaning in securities law than in contract law." *McKesson HBOC, Inc. v. N.Y. State Common Ret. Fund, Inc.*, 339 F.3d 1087, 1092 (9th Cir. 2003); *Diskin v. Lomasney & Co.*, 452 F.2d 871, 875 (2d Cir. 1971) ("[T]he statutory language defining 'offer'…goes well beyond the common law concept of offer."). As the Supreme Court noted in *United States v. Naftalin*, 441 U.S. 768 (1970), Congress intended a broad construction of the phrase "in the offer or sale," which is "expansive enough to

[2] Defendants do not contest the sufficiency of the evidence that they made materially false representations and engaged in a scheme to defraud, which itself speaks volumes about the likelihood of future violations and need for injunctive relief.

encompass the entire selling process, and noting that Section 2(3) provides that "'offer' shall include *every attempt* or offer to dispose of . . . a security or interest in a security, for value" and that "[t]his language does not require that the fraud occur in any particular phase of the selling transaction.") (emphasis in original).

Although defendants acknowledge the import of *Naftalin* and the breadth of the "offer" definition in the Securities Act (Opp. at 6), they ignore the fact that, under federal securities law, whether or not an investor was able to consummate a transaction is irrelevant to the question of whether an offer for a security was made. Defendants instead argue that there could not have been an offer because there was no "intent to be bound," since a purchaser could not press the "Buy Now" button on the Blockvest website and buy a token. Opp. at 7.[3]

But an "offer" need not be able to be accepted to be an "offer" under the Act. For example, in *SEC v. Cavanagh*, 155 F.3d 129, 135 (2nd Cir. 1998), the defendant argued that negotiations of a transaction were not an offer because a condition remained before the offeree could accept. The Second Circuit disagreed:

> [Defendant] argues that these discussions …did not constitute an 'offer' because they were unenforceable, as the closing of the Acquisition Agreement was a condition precedent of the sale. However, the Act defines an 'offer' to include 'every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.' This definition extends beyond the common law contract concept of an offer and clearly covers [defendant's] negotiations.

Id.; *see also SEC v. Thomas D. Kienlen Corp.*, 755 F. Supp. 936, 940-941 (D. Or. 1991) ("Impossibility of performance is not dispositive to the court's determination of whether defendants' conduct constituted an 'offer to sell.' What is dispositive to the court's determination is whether defendants' conduct conditioned the public

[3] Defendants argue that *Naftalin* merely holds that Section 17(a)(1) does not require that a fraud be "upon the purchaser," and the rest is *dicta*. Opp. at 10. But defendants point to no caselaw under the Securities Act for the notion that an offer under Section 2(3) requires a "manifestation of intent to be bound." Opp. at 9.

mind."); *SEC v. Commercial Inv. & Dev. Corp. of Fl.*, 373 F. Supp. 1153, 1164 (S.D. Fla. 1974) ("letter [whose purpose was] to solicit [] shareholders to offer to buy part of the proposed public offering" was an "offer to sell").[4] Defendants' uncontested promotion of their offering to the public was an offer under the Securities Act.

B. Defendants Acted With Scienter and Negligence

In their opposition, defendants also focus on the record of their scienter and negligence. Section 17(a)(1) requires proof of scienter, while Section 17(a)(2) and (3) may be satisfied through a showing of negligence. Mot. at 9, citing *SEC v. GLT Dain Rauscher, Inc.*, 254 F.3d 852, 855 (9th Cir. 2001). Scienter requires "'knowing or reckless conduct,' without a showing of 'willful intent to defraud'" (*Vernazza v. SEC*, 327 F.3d 851, 859-60 (9th Cir. 2003)), while to establish negligence, the SEC must show that defendants failed to conform to the standard of care of a reasonable person. *See Dain Rauscher*, 254 F.3d at 856.

Defendants claim in opposition to the SEC's motion that they did not act with scienter or even negligence, but rather, that they acted in "good faith." Opp. at 10-11. Citing solely a declaration by Ringgold that the Court denied them leave to file, defendants argue they simply "made mistakes" and that they had engaged a compliance officer to review their public representations before the SEC sued them. *Id.*, citing Dkt. No. 32. Putting aside that the evidence they cite was excluded by the Court, none of what defendants argue disproves their scienter or negligence.

It is uncontested that from March 2018 until the Court issued its TRO in early October 2018, defendants advertised the BLV token offering to the public—on Blockvest's website, through social media channels, and in Ringgold's live

[4] Defendants seek to distinguish *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, 426 F.2d 569 (2nd Cir. 1970), because it involved Section 5 claims, whereas the SEC is moving for reconsideration on its Section 17(a) claim. Opp. at 10. But given that Section 5 and Section 17(a) of the Securities Act share the same statutory definition of "offer," the *Chris-Craft* discussion is instructive.

appearances—based on multiple, blatantly deceptive representations and acts. That it was an offering of securities was something defendants did not dispute at the time—they openly called it a "securities offering," claiming it was "SEC approved" and was "registered with" the SEC and/or exempt from registration. They falsely invoked the seals and imprimatur of the SEC and the Commodities Futures Trading Commission, as well as the logos of the National Futures Association and Deloitte & Touche, all of with whom defendants then claimed to be affiliated, but now admit they were not. Their prolonged course of public deception occurred alongside defendants' creation of the "BEC" (the "Blockchain Exchange Commission")—a concededly fake regulator advertised as being at SEC headquarters, with a link to the SEC's website and a copycat government seal. The idea that defendants created a fake regulator and used it to promote their offering in "good faith" is absurd.

Defendants do not contest that these Ringgold-controlled website and social media posts, and Ringgold's public appearances, contained unabashedly deceptive falsehoods—a fact the Court observed at the preliminary injunction hearing. *See* Opp. at 11; *see also* Nov. 16, 2018 Hearing Transcript at 19:7-10 ("It looks like there's just boldface lies that are being presented as far as the SEC sanctioning, approving, and whether or not you have Deloitte involved…"). Nor do they dispute that they made their outlandish representations to the public for a period spanning several months before they first hired a chief compliance officer in June 2018 (Dkt. No. 24, ¶ 9)—let alone before he performed any work—and continued to make them until they retained counsel after the TRO was issued. Therefore, this record amply supports a finding that defendants acted at least with a reckless disregard for the truth and with negligence.[5]

[5] Defendants also argue that the SEC must, under Section 17(a)(3), "show a course of business ***which operates as*** a fraud or deceit 'upon the purchaser'" (Opp. at 11; emphasis added), while defendants argue they had no purchasers. However, Section 17(a)(3) provides that, "[i]t shall be unlawful for any person in the offer or

IV. DEFENDANTS' PROMISE TO STOP THEIR OFFERING DOES NOT SUFFICIENTLY PROTECT THE PUBLIC

The second basis for the SEC's reconsideration motion is that under Ninth Circuit law, including *SEC v. Murphy*, 626 F.3d 633 (9th Cir. 1980), Ringgold's promise to put his fraudulent offering on hold—subject to giving the SEC thirty days' notice if he planned to resume—does not render a preliminary injunction unnecessary. Mot. at 24. Defendants' opposition sounds a single note: that the SEC's failure to set forth evidence of new violations occurring after November 27th proves that an injunction was not needed. Opp. at 5-6.

As set forth in the SEC's motion, Ninth Circuit authority has considered, and rejected, the notion that an injunction is unnecessary where defendants stop their violative conduct after they are sued. *See* Mot. at 23-25, citing cases. The SEC's motion seeks reconsideration based on the Opinion's ruling to the contrary. The argument that defendants are not alleged to have committed additional violations since late November does not detract from the undisputed record of misconduct that led to the SEC's action, nor from the need for a preliminary injunction.

Were the Court to consider any subsequent developments as germane to the motion, the only new evidence is that defendants, as soon as the Opinion was entered, attempted to violate Federal Rule of Civil Procedure Rule 11 and Local Rule 83.3(f)(1), which prohibits represented parties from acting other than through counsel. What appears to have been a major underpinning of the Court's basis for denying a preliminary injunction—defendants' willingness to employ and abide by

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sale of securities…directly or indirectly…(3) to engage in any transaction, practice or course of business which operates ***or would operate*** as a fraud or deceit upon the purchaser" (emphasis added). Section 17(a) applies to offers, and the plain language of Section 17(a)(3) proscribes not just practices that do operate to deceive, but also those which would in the future work as a deceit upon putative investors. Defendants make the same argument about Section 17(a)(2), arguing it requires the SEC to show "that the Defendant received value for the sale of the security." Opp. at 11. But this reading would restrict Section 17(a)(2) to sales, whereas Section 17(a)(2) makes it illegal "to obtain money or property" by means of misrepresentations—including through an offer of a security.

competent counsel—has disappeared. *See* Dkt. No. 41 at 16 (noting, of defendants' misrepresentations after the TRO, that "Defendants…***had not yet retained counsel*** in his matter"); *id.* (the SEC had not "presented any misrepresentations by Defendants ***since they have retained counsel***"); *id.* ("[w]hile there is evidence that Ringgold made misrepresentations shortly after the complaint was filed and ***prior to having retained counsel***, Ringgold, ***with counsel, now asserts*** he will not pursue the ICO"); *id.* at 15 (noting Ringgold statement that he "will not proceed until his ***securities compliance counsel*** is capable of ensuring compliance …"; emphases added). The inference invited is that Ringgold's retention of counsel would serve as a check against potential future violations. The SEC respectfully submits that the Court should reevaluate that inference in light of the information in defense counsel's withdrawal motion. Dkt. No. 47 at 8-9. Given the SEC's evidence that defendants repeatedly misrepresented material facts in multiple forums, they should not be able to avoid an injunction by simply vowing to obey Section 17(a).

V. CONCLUSION

For the foregoing reasons, the SEC respectfully requests that the Court reconsider, in part, its denial of the SEC's application for preliminary injunction, and preliminarily enjoin Defendants from violating 17(a) of the Securities Act.

Dated: January 25, 2019

Respectfully submitted,

/s/ Amy Jane Longo
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PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

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On January 25, 2019, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S REPLY IN SUPPORT OF MOTION FOR PARTIAL RECONSIDERATION OF ORDER DENYING PRELIMINARY INJUNCTION (Dkt. No. 41)** on all the parties to this action addressed as stated on the attached service list:

☐ **OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

☐ **PERSONAL DEPOSIT IN MAIL:** By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

☐ **EXPRESS U.S. MAIL:** Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

☐ **HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

☐ **UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

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☐ **FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: January 25, 2019

/s/ Amy Jane Longo
Amy Jane Longo

SEC v. Blockvest LLC, et al.
United States District Court – Southern District of California
Case No. 3:18-cv-02287-GPC-MSB

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