UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-20650

In the Matter of

American CryptoFed DAO LLC,

Respondent.

DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENT'S MOTION TO DISMISS THE ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS

The Division of Enforcement ("Division") of the U.S. Securities and Exchange Commission ("Commission") respectfully submits this opposition to American CryptoFed DAO LLC's ("Respondent" or "American CryptoFed") December 19, 2021 Motion to Dismiss the Order Instituting Administrative Proceedings (the "Motion").

I. The Legal Standard for a Ruling on the Pleadings.

The Motion seeks to dismiss the Order Instituting Proceedings ("OIP") in this matter under Rule 250(a), which provides for a ruling on the pleadings. As the Commission has explained:

> Rule 250(a) . . . permits any party, no later than 14 days after a respondent's answer has been filed, to move for a ruling on the pleadings on one or more claims or defenses. Rule 250(a) thus permits a respondent to seek a ruling as a matter of law based on the factual allegations in the OIP and permits either party to seek a ruling as a matter of law after the filing of an answer. We have recognized that the procedure provided under Rule 250(a) is analogous to that applicable in federal district court to motions to dismiss and for judgment on the pleadings under Rules 12(b)(6) and 12(c) of the

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> Federal Rules of Civil Procedure. We have also considered precedent construing the Federal Rules of Civil Procedure when construing our Rules of Practice (although that precedent does not bind us when doing so). As with a motion under Federal Rules of Civil Procedure 12(b)(6) and 12(c), to succeed on a motion under Rule 250(a), ***a movant must establish that even accepting all of the nonmovant's factual allegations as true and drawing all reasonable inferences in the non-movant's favor, the movant is entitled to a ruling as a matter of law.***

ERHC Energy, Inc. et al., Exchange Act Release No. 90517, 2020 SEC LEXIS 4969, *3-4 (November 24, 2020) (cleaned up) (emphasis added).

II. American CryptoFed Is Not Entitled to a Ruling on the Pleadings.

A. American CryptoFed's Assertions Are Undercut by the Allegations in the OIP.

Respondent asserts that it is entitled to a ruling on the pleadings because "there are no existing and potential investors to be protected."[1] As Respondent explains it, after Respondent's September 16, 2021 Form 10 becomes effective, and before the Commission declares Respondent's Form S-1 effective, the only distributions that will take place of Locke tokens will be for free, and those tokens will be restricted, untradeable tokens with no possible secondary market. Therefore, according to Respondent, no investors can be harmed and the Commission must dismiss this proceeding.

It is simply not true that there is no risk of harm to investors. Taking the factual allegations of the OIP as true and drawing all reasonable inferences in the Division's favor means that the following allegations in the OIP are deemed true:

[1] Motion at 2.

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- Respondent's Form 10 fails to contain required financial information including audited financials;[2]
- Respondent's Form 10 fails to contain required management discussion and analysis of financial information;[3]
- Respondent's Form 10 fails to contain a compliant beneficial ownership table;[4]
- Respondent's Form 10 fails to contain a compliant executive compensation table;[5]
- Respondent's Form 10 fails to contain required exhibits;[6]
- Respondent's Form 10 fails to contain a clear and complete description of the general development of American CryptoFed's business;[7]
- Respondent's Form 10 fails to contain a clear and complete description of the terms, rights and obligations of the securities to be registered;[8]
- Respondent's Form 10 makes materially misleading statements that the Ducat and Locke tokens both are securities and are not securities;[9] and
- Respondent's Form 10 makes materially misleading statements by stating a plan to use Form S-8 to distribute the tokens without disclosing that Form S-8 is not legally available for the distribution American CryptoFed plans to make.[10]

Those serious allegations, deemed true for present purposes, make clear that there are risks to investors if American CryptoFed is allowed to proceed as it intends.

[2] OIP at ¶ 6

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.* at ¶7.

[10] *Id.* at ¶8.

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B. Investors Will Be Harmed if American CryptoFed's Form 10 Becomes Effective.

1. Investors Who Eventually Pay for Locke Tokens Will Be Harmed.

Respondent contends that the Commission cannot institute a Section 12(j) proceeding to deny a defective registration statement until investors start suffering harm. That theory is nonsensical and contrary to the purpose and intent of the statutory scheme of the federal securities laws. The Commission routinely acts to protect both current and potential investors under Section 12(j), and has specifically noted the need to protect potential investors:

> In evaluating what is necessary or appropriate to protect investors, regard must be had not only for existing stockholders of the issuer, but also for potential investors. Indeed, we have emphasized the significant interests of prospective investors who can be substantially hindered in their ability to evaluate an issuer in the absence of current filings. In any event, both existing and prospective shareholders are harmed by the continuing lack of current and reliable financial information for the company.

A-Power Energy Generation Systems, Exchange Act Release No. 69439, 2013 WL 1755036 at *3 (April 24, 2013). Accordingly, the Commission does not need to wait until investors actually incur harm to bring a proceeding under Section 12(j), especially when—as here—there is a high likelihood that prospective investors will be harmed by the defective registration statement.

Here, even assuming as true Respondent's claim that no investor will purchase any Locke tokens until after the Commission deems American CryptoFed's Form S-1 effective, Respondent clearly plans to begin selling Locke

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tokens at some point, or else Locke tokens would never increase in value.[11] If American CryptoFed's Form 10 is allowed to become effective as presently written, any future purchasers of Locke tokens will be harmed because they will be purchasing tokens on the basis of a materially deficient and misleading registration statement. The Commission has repeatedly recognized the need to take action under Section 12(j) to protect investors from issuers deficient filings. For example, in *Citizens Capital Corp.*, the Commission found the filings to be "materially deficient" because they "lacked audited financial statements." Exchange Act Release No. 67313, 2012 SEC LEXIS 2024 at *21-22 (June 29, 2012). Accordingly, the Commission revoked the registration of the issuer's securities, citing "the need to protect investors." *Id.* at *41. Additionally, in *Calais Resources, Inc.*, the Commission revoked registration under Section 12(j) where an issuer lacked audited financial statements, and noted that "we agree . . . that revocation is necessary or appropriate for the protection of investors." Exchange Act Release No. 67312, 2012 SEC LEXIS 2023 at *14, 25-26 (Jun. 29, 2012).[12] This harm is sufficient to deny Respondent's Motion, but there are additional harms that will flow from letting its Form 10 become effective.

[11] *See* Exhibit A to Respondent's Answer at 22, 29, 32 (Respondent's Form 10), hypothesizing the Locke token may reach $0.10 in value.

[12] *See also Queensboro Gold Mines, Ltd.*, 2 S.E.C. 860, 862-863 (1937) (suspending registration statement under Securities Act Section 8(d) due to failure to include fully audited financial information); *Reg. Statements of Crest Radius et al.*, Initial Dec. Rel. No. 1406 2021 SEC LEXIS 42, at *10 (Jan. 5, 2021) (suspending registration statement under Securities Act Section 8(d) due in part to the fact that information required by under Regulation S-K and Regulation S-X was false, and noting that "the materiality of this type of information 'relating to financial condition, solvency and profitability is not subject to serious challenge.'") (quoting *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980).

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2. The Potential Violation of Section 5 by Respondent and Its Agents Is a Harm.

If Respondent's Form 10 becomes effective, American CryptoFed clearly intends to begin "mass distribution" of its tokens. This will cause harm through a potential violation of Securities Act Section 5, 18 U.S.C. §77e, by American CryptoFed and the individuals assisting it in an unregistered securities offering. American CryptoFed's Form 10 states that after it becomes effective, American CryptoFed is planning a "mass distribution"[13] to more than 500 persons[14] through a Form S-8 that would be automatically effective upon filing.[15] The Form 10 further claims that each of these token recipients would be a "consultant" or an "advisor" because "[b]y holding Locke tokens *per se*, token holders by definition perform services to [American] CryptoFed, because the [American] CryptoFed token economy needs a network effect of mass token holders to overcome the inherent hurdles of collective action."[16]

But contrary to American CryptoFed's assertions, this distribution is not a valid use of Form S-8. Among other problems, American CryptoFed only classifies these token recipients as contractors or advisors because they are providing the "service" of receiving the tokens in the mass distribution. Persons who perform such a service are expressly prohibited from receiving securities via a Form S-8

[13] *See* Exhibit A to Respondent's Answer at 5-6 (Respondent's Form 10).

[14] The Division is assuming, for the purposes of this motion, that the distribution is only to persons, not entities.

[15] *See* 17 C.F.R. § 230.462.

[16] Exhibit A to Respondent's Answer at 5 (Item 1) and 25 (Item 2.7) (Respondent's Form 10).

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distribution. Rather, Form S-8 has a specifically limited purpose and scope, as the court in *SEC v. iBIZ Tech. Corp* explained:

> Form S-8 is an abbreviated registration statement that companies can use to register shares the company offers or sells to its employees or consultants, provided they are natural persons, provide bona fide services to the company, and are not involved in capital raising transactions. ***Companies can use Form S-8 only to issue stock as compensation for consultants for bona fide services not connected with capital raising.***

2008 U.S. Dist. LEXIS 107297, at *6-7,CV 06-502-PHX-JAT (D. Ariz. July 21, 2008) (emphasis added) (cleaned up). The court continued: "Companies cannot use consultants who receive S-8 stock as conduits to the public market. They cannot misuse Form S-8 to 'circumvent the registration requirement by devious and sundry means.'" *Id.* at *7-8 (quoting *North Am. Research and Dev. Corp.*, 424 F.2d 63, 71 (2d Cir. 1970)); *see also SEC v. Phan*, 500 F.3d 895, 903-904 (9th Cir. 2007).

Because American CryptoFed plans an offering pursuant to Form S-8 that cannot be covered by a Form S-8, if the Locke token is determined to be a security, as claimed on the cover section of Respondent's Form 10,[17] then American CryptoFed is planning a securities offering that is not covered by any registration statement. *See SEC v. Cavanagh,* 155 F.3d at 133 ("A registration statement permits an issuer, or other persons, to make ***only*** the offers and sales described in the registration statement.") (emphasis added). Accordingly, a harm that would result from Respondent's Form 10 becoming effective is that American CryptoFed—***and all those persons providing substantial assistance to American***

[17] Exhibit A to Respondent's Answer at 2 (Respondent's Form 10).

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CryptoFed regarding the distribution—could violate Section 5 of the Securities Act by engaging in an unregistered securities offering. A court recently found that a different planned mass token distribution would cause harm for similar reasons: "The Court also finds that the delivery of Grams to the Initial Purchasers, who would resell them into the public market, represents a near certain risk of a future harm, namely the completion of a public distribution of a security without a registration statement." *SEC v. Telegram*, 448 F. Supp. 3d 352, 382 (S.D.N.Y. 2020).

3. Token Recipients Will Be Harmed by Being Deceived Into Potential Section 5 Violations Themselves.

Another harm that may result if Respondent's Form 10 becomes effective is that token recipients will be deceived about their ability to resell the tokens legally. If American CryptoFed distributes the tokens via a Form S-8 as described, the recipients will receive tokens that they will believe were distributed to them legally pursuant to a valid registration statement. In fact, as described above, the offering will not be properly registered and the token recipients would be receiving restricted securities that could only be sold pursuant to Securities Act Rule 144, 17 C.F.R. § 230.144 or another valid exemption from Securities Act Section 5. Because American CryptoFed's Form 10 does not alert them of this problem, the recipients could unknowingly violate Section 5's prohibition against unregistered offerings.

4. All Investors Are Harmed When the Commission Is Prevented from Ensuring a Well-Regulated Market.

If Respondent's materially deficient and misleading Form 10 becomes effective, there will be a harm to the Commission's ability to regulate a well-ordered marketplace, which in turn harms all investors. The Commission's ability to require

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that investors be given adequate and accurate information before making investment decisions will be seriously impaired if issuers are permitted to engage in mass distribution of securities while blatantly disregarding the requirements of Exchange Act. American CryptoFed's argument that there will be no secondary market trading until after the Form S-1 is declared effective is a red herring. Even if true, this still means that American CryptoFed could distribute ***hundreds of billions*** of Locke tokens that (1) are registered as securities by a document that denies they are securities, (2) are registered by a document that omits critical required information, and (3) are illegally distributed by a Form S-8 to persons who do not meet the specified definition of employee, contractor or advisor. That is harm. And the Commission is well-within its authority to institute proceedings to protect investors from a mass distribution founded on critical omissions and material misstatements in a document filed with the Commission.

C. American CryptoFed May Plan Additional Distributions.

Respondent's present interpretation that its Form 10 and attachments prohibit additional offerings or sales of Locke are at odds with a plain reading of the documents. For instance, Respondent claims on page 2 of the Motion that: "[b]efore CryptoFed's S-1 registration statement is declared effective, by design, Respondent only distributes Locke tokens, free of charge." (internal quotations omitted). Respondent cites to Section 14.6 of the American CryptoFed DAO's Constitution to support this assertion, but that Section only discusses the ***initial*** distribution of

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Locke tokens being "free of charge."[18] The American CryptoFed Constitution does not prevent ***subsequent*** distributions of Locke tokens via sales before the Form S-1 is declared effective.[19] In addition, Respondent's Form 10 in Section 2.4.1.1.1. contemplates an "Initial Locke Allocation" that would reserve 10% of the maximum authorized number of Locke tokens for "refundable auctions on crypto exchanges for price discovery."[20] Therefore, despite Respondent's claims in the Motion, and certainly taken in the light most favorable to the Division, the Form 10 and its attachments do not contain absolute assurances that Respondent will not sell Locke tokens before the Form S-1 becomes effective.

CONCLUSION

Accordingly, the Division respectfully requests that the Commission deny Respondent's Motion to Dismiss the Administrative Proceedings.

Dated: December 22, 2021

Respectfully submitted,

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[18] Exhibit B to Respondent's Answer at 12.

[19] To the extent there is ambiguity in these documents, for the purposes of this Motion, that ambiguity must be construed against American CryptoFed.

[20] Exhibit A to Respondent's Answer at 21.

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CERTIFICATE OF SERVICE

I hereby certify that I caused true copies of the Division of Enforcement's Opposition to Respondent's Motion to Dismiss the Order Instituting Proceedings to be served on the following on December 22, 2021, in the manner indicated below:

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