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11 **UNITED STATES DISTRICT COURT**
12 **NORTHERN DISTRICT OF CALIFORNIA**
13 **SAN FRANCISCO DIVISION**
14

15 SECURITIES AND EXCHANGE COMMISSION,
16 Plaintiff,
17 v.
18 BLOCK BITS CAPITAL, LLC, BLOCK BITS
19 CAPITAL GP I, LLC and JAPHETH DILLMAN,
20 Defendants.

Case No. 3:22-cv-2563

COMPLAINT

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23 Plaintiff Securities and Exchange Commission (the “Commission”) alleges:

24 **SUMMARY OF THE ACTION**

25 1. Defendants Block Bits Capital, LLC (“Block Bits Capital”), Block Bits Capital
26 GP I, LLC (“Block Bits GP”) (collectively “Block Bits”), and their founder and Managing
27 Director, Defendant Japheth Dillman (“Dillman”) engaged in the fraudulent and unregistered
28 offer and sale of securities. Dillman was the primary architect of the fraud, and with his co-

1 founder and co-Managing Director David Mata (“Mata”), Block Bits and Dillman promoted the
2 offering and raised at least \$960,000 for the Fund from approximately 22 retail investors, from at
3 least July through December 2017. The Commission has filed a separate action against Mata.

4 2. Block Bits’ offering materials falsely stated that it had developed an in-house
5 proprietary auto-trading bot, which would trade a hundred different digital assets or
6 “cryptocurrencies” over thirty different trading platforms based on parameters defined by Block
7 Bits to maximize returns for the Block Bits Fund I, LP (the “Fund”) in which investors
8 purchased securities. In reality, Block Bits never developed a functional auto-trading bot. The
9 only trading for the Fund was done manually by Mata through a digital asset trading platform
10 account.

11 3. Dillman also misrepresented to Block Bits investors that 40% of the Fund’s
12 assets were invested in “cold storage” (offline) deals that would generate substantial returns and
13 be held in risk-free conditions. In reality, at no time were any of the Fund’s assets stored in
14 offline wallets or other risk-free “cold storage” to generate returns. Instead, Dillman and Mata
15 used the investor funds to continue manually trading and for investments that carried significant
16 risk, including in unsecured loans and an investment in a related company’s initial coin offering
17 of another digital asset, AML Bitcoin. Plaintiff also has alleged AML Bitcoin was a fraudulent
18 unregistered offering in *SEC v. NAC Foundation, LLC, et al.* (Dkt. 1; Case No. 3:20-cv-04188
19 (N.D. Cal., filed June 25, 2020)).

20 4. In this action, the Commission seeks injunctions; disgorgement of ill-gotten
21 gains, with prejudgment interest; civil monetary penalties; and other appropriate relief. Unless
22 Block Bits and Dillman are permanently restrained and enjoined, they will continue to engage in
23 the acts, practices, and courses of business set forth in this complaint and in acts, practices, and
24 courses of business of similar type and object.

25 JURISDICTION AND VENUE

26 5. The Commission brings this action pursuant to Sections 20(b), 20(d), and 22(a)
27 of the Securities Act of 1933 (“Securities Act”) [15 U.S.C. §§ 77t(b), 77t(d), and 77v(a)],
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1 Sections 21(d), 21(e), and 27 of the Securities Exchange Act of 1934 (“Exchange Act”)
2 [15 U.S.C. §§ 78u(d), 78u(e), and 78aa], and Section 209(d) of the Advisers Act of 1940
3 (“Advisers Act”) [15 U.S.C. § 80b-9(d)].

4 6. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1)
5 and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d)(1), and 77v(a)], Sections 21(d), 21(e)
6 and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa], and Sections 209(d), 209(e),
7 and 214 of the Advisers Act [15 U.S.C. §§ 80b-9(d), 80b-9(e), and 80b-14].

8 7. Defendants, directly or indirectly, made use of the means and instrumentalities of
9 interstate commerce or of the mails in connection with the acts, transactions, practices, and
10 courses of business alleged in this complaint.

11 8. Venue is proper in this District pursuant to Section 22(a) of the Securities Act
12 [15 U.S.C. § 77v(a)], Section 27(a) of the Exchange Act [15 U.S.C. § 78aa(a)], and Section 214
13 of the Advisers Act [15 U.S.C. § 80b-14]. Acts, transactions, practices, and courses of business
14 that form the basis for the violations alleged in this complaint occurred in this District. During
15 the period described in this Complaint, Dillman met with and solicited prospective investors in
16 this District, and offers and sales of securities took place in this District. Defendants Block Bits
17 Capital and Block Bits GP have maintained their principal places of business in San Francisco,
18 California, in this District. Defendant Dillman also resides in this District.

19 9. Under Civil Local Rule 3-2(d), this civil action should be assigned to the San
20 Francisco Division, because a substantial part of the events or omissions which give rise to the
21 claims alleged herein occurred in San Francisco County.

22 DEFENDANTS

23 10. **Block Bits Capital, LLC (“Block Bits Capital”)** is a California limited liability
24 company formed in 2017 with its principal place of business in San Francisco, California.
25 According to the Form D filed by the Fund with the Securities and Exchange Commission,
26 Block Bits Capital is the Investment Manager of the Fund. Dillman and Mata are each 50%
27 owners and Managing Members of Block Bits Capital.

1 partnership interests in the Fund, which were offered and sold as investment contracts, and
2 therefore as securities, under the federal securities laws.

3 16. Defendants' statements about the development of the auto-trader and purported
4 returns on investment were important to investors because these features were touted as
5 improvements over manual trading, which was a principal basis upon which investors were led
6 to reasonably expect profits on their investments.

7
8 **B. Block Bits, Dillman, and Mata Engaged in Deceptive Acts During the**
9 **Offering and While Operating the Fund**

10 1. Misrepresentations and Other Deceptive Acts Relating to the Operation
11 and Performance of the Auto-Trader

12 17. Dillman and Block Bits made materially false and misleading statements about
13 the status of the purported auto-trading technology in offering materials, social media posts, and
14 marketing efforts directed by Dillman. In reality, Block Bits never completed development of
15 the auto-trader and only funded early stage development efforts. No functional auto-trader was
16 ever tested or deployed and all of the trading of Fund assets was done by Mata manually.
17 Dillman and Mata frequently discussed during the offering and while operating the Fund that the
18 auto-trading bot was not yet functional and that Mata needed to continue doing manual trading in
19 an effort to generate profits for the Fund.

20 18. Dillman repeated and doubled-down on numerous material misrepresentations
21 about the status of the auto-trading bot in emails to investors from June through September 2017.
22 Although Dillman told investors that there were delays in the deployment of the auto-trading bot
23 and that Mata had traded by hand in July 2017, Dillman misrepresented the current state and
24 performance of the automated trading. For instance, on July 9, 2017, Dillman touted to investors
25 that "we're doing much more than merely investing in cryptocurrency ... we've built an
26 autotrader that does arbitrage across the 30 different exchanges using multiple currencies. Our
27 returns have been pretty mind boggling to date." On August 1, 2017, Dillman stated that "the
28 arbitrage bot we have developed in house ... takes advantage of the price disparity on the

1 exchanges, buying low and selling high.” On September 25, 2017, he further stated that “[w]e
2 have created automation that capitalizes on the differentiation in pricing between exchanges and
3 between currencies. This ensures we have some of the best gains in the market, numbers that
4 almost seem too good to be real. We have finished the Arbitrage AutoTrader.”

5 19. Dillman went so far as to make up false “returns on investment” about purported
6 trading “tests” that Block Bits supposedly conducted using the auto-trader. He sent prospective
7 investors emails describing the returns as “jaw dropping,” “eye-popping” and “insane.”

8 20. In reality, Dillman fabricated the performance “results.” Block Bits hired
9 software and blockchain developers, but only funded early stage development. No functional
10 auto-trader was ever tested or deployed.

11 21. Dillman was aware at all times during the offering and while operating the Fund
12 that Block Bits’ auto-trader was not functional and that Mata was manually trading the Fund’s
13 investments in digital assets through a third-party digital asset trading platform account, and that
14 the offering and marketing materials claiming that Block Bits had already developed the auto-
15 trader were false and misleading.

16 2. Misrepresentations and Other Deceptive Acts Relating to the Purported
17 “Cold Storage” Investments

18 22. As part of Defendants’ fraudulent scheme, Dillman also misrepresented to
19 investors in the Fund that 40% of the Fund’s assets were invested in “cold storage” deals that
20 would generate substantial returns and be held in risk-free conditions.

21 23. Dillman emailed investors on August 1, 2017, that Block Bits had struck a deal to
22 place 25 of the Fund’s Bitcoins in “cold storage” for three months, at the end of which the Fund
23 would receive 50 Bitcoins, a 100% return. On November 23, 2017, Dillman emphasized to
24 investors via email that keeping some of the Fund’s digital assets offline in “cold storage” would
25 generate returns and keep its assets safe.

26 24. However, at no time were any of the Fund’s assets stored in offline wallets or
27 other risk-free “cold storage” to generate returns. Instead, Dillman and Mata used the investor
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1 funds to continue manually trading in digital assets and for investments with risks including: 1)
2 an unsecured loan of digital assets worth about \$65,500 to promote a startup company's initial
3 coin offering ("ICO"); 2) a \$50,000 loan to another startup company where Mata's friend
4 worked; and 3) \$101,000 for investments in the ICO of AML Bitcoin.

5 25. Dillman and Mata prepared rudimentary contracts to conceal the true nature and
6 risks of these digital asset investments. They submitted the agreements as evidence of the
7 purported "cold storage" investments to the Fund's accountants, who prepared the financial
8 statements for distribution to investors. Accordingly, all of these high-risk investments were
9 misrepresented as "cold storage" assets with expected gains on the Fund's Schedule of Gains and
10 Losses distributed monthly to investors, rather than high-risk unsecured loans or ICO
11 investments.

12 26. Defendants were aware the contracts did not reflect the actual risks associated
13 with the Fund's investments, and provided the contracts to the accountants with knowledge that
14 this would result in deceptive information being provided to the investors in the form of monthly
15 financial statements reflecting that some Fund assets were invested in risk-free "cold storage"
16 deals to generate returns.

17 **C. Dillman and Block Bits GP Withdrew Excess Compensation From the Fund**

18 27. According to the Limited Partnership agreement for the Fund, Block Bits GP was
19 entitled to 50% of any profits made by the Fund on a monthly basis. From September 2017
20 through December 2018, Dillman transferred approximately \$300,000 of the Fund's assets to
21 Block Bits GP, through which Dillman used the money to pay employee salaries, contractors,
22 and other expenses, including \$67,500 that Dillman transferred to his personal account.

23 28. However, Mata's manual trading (calculated on a monthly basis during the period
24 when Block Bits GP was making these withdrawals) generated a total of about \$200,000 in
25 returns. Additionally, the "returns" from the loans falsely characterized as "cold storage"
26 investments not only failed to materialize, but Defendants lost approximately \$180,000 of the
27 principal used for these investments, which left only \$20,000 in profits for the Fund. Based on
28

1 the Limited Partnership agreement, Block Bits GP was only entitled to 50% of any trading
2 profits, or \$10,000, and withdrew \$290,000 in excess, unauthorized compensation.

3 **FIRST CLAIM FOR RELIEF**

4 *Violations of Section 10(b) of the Exchange Act and Rule 10b-5*

5 *By All Defendants*

6 29. The Commission re-alleges and incorporates by reference Paragraph Nos. 1
7 through 28.

8 30. By engaging in the conduct described above, Defendants Block Bits Capital,
9 Block Bits GP and Dillman, directly or indirectly, in connection with the purchase or sale of
10 securities, by the use of means or instrumentalities of interstate commerce, or the mails, with
11 scienter:

- 12 (a) Employed devices, schemes, or artifices to defraud;
- 13 (b) Made untrue statements of material facts or omitted to state material facts
14 necessary in order to make the statements made, in the light of the
15 circumstances under which they were made, not misleading; and
- 16 (c) Engaged in acts, practices, or courses of business which operated or
17 would operate as a fraud or deceit upon other persons, including
18 purchasers and sellers of securities.

19 31. By reason of the foregoing, Defendants violated, and unless restrained and
20 enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and
21 Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

22 **SECOND CLAIM FOR RELIEF**

23 *Violations of Section 17(a) of the Securities Act*

24 *By All Defendants*

25 32. The Commission re-alleges and incorporates by reference Paragraph Nos. 1
26 through 28.

FOURTH CLAIM FOR RELIEF

Violations of Sections 206(1) and 206(2) of the Advisers Act

By All Defendants

38. The Commission re-alleges and incorporates by reference Paragraph Nos. 1 through 28.

39. At all relevant times, Defendants Block Bits Capital, Block Bits GP and Dillman were “investment advisers” within the meaning of Section 202(a)(11) of the Advisers Act [15 U.S.C. § 80b-2(a)(11)]. Defendants Block Bits Capital, Block Bits GP and Dillman each were in the business of providing investment advice concerning securities for compensation. Defendant Dillman was also an investment adviser due to his ownership, management and control of Defendants Block Bits Capital and Block Bits GP.

40. As set forth above, Defendants, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, acting intentionally, knowingly or recklessly: (a) have employed or are employing devices, schemes, or artifices to defraud clients and/or potential clients; or (b) have engaged or are engaging in transactions, practices, or courses of business which operate as a fraud or deceit upon a client or prospective client.

41. By reason of the foregoing, Defendants directly or indirectly violated, and unless restrained and enjoined will continue to violate, Sections 206(1) and (2) of the Advisers Act [15 U.S.C. § 80b-6(1) and (2)].

FIFTH CLAIM FOR RELIEF

Violations of Section 206(4) of the Advisers Act and Rule 206(4)-8

By All Defendants

42. The Commission re-alleges and incorporates by reference Paragraph numbers 1 through 28.

43. At all relevant times, Defendants Block Bits Capital, Block Bits GP and Dillman acted as investment advisers to the Fund, a pooled investment vehicle as defined in Advisers Act Rule 206(4)-8(b) [17 C.F.R. § 275.206(4)-8(b)].

1 44. Defendants Block Bits Capital, Block Bits GP and Dillman, while acting as
2 investment advisers to a pooled investment vehicle, by use of the mails, and the means and
3 instrumentalities of interstate commerce, directly or indirectly, engaged in acts, practices, or
4 courses of businesses which were fraudulent, deceptive or manipulative. Defendants Block Bits
5 Capital, Block Bits GP and Dillman engaged in acts, practices, or courses of businesses that were
6 fraudulent, deceptive or manipulative with respect to investors or prospective investors in the
7 pooled investment vehicle.

8 45. By reason of the foregoing, Defendants directly or indirectly violated, and unless
9 restrained and enjoined will continue to violate, Section 206(4) of the Advisers Act [15 U.S.C. §
10 80b-6(4)] and Rule 206(4)-8 thereunder [17 C.F.R. § 275.206(4)-8].

11 **PRAYER FOR RELIEF**

12 WHEREFORE, the Commission respectfully requests that this Court:

13 **I.**

14 Permanently enjoin Defendants Block Bits Capital, Block Bits GP and Dillman from
15 directly or indirectly violating Sections 5 and 17(a) of the Securities Act [15 U.S.C. §§ 77e and
16 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R.
17 § 240.10b-5] thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act [15
18 U.S.C. §§ 80b-6(1), 80b-6(2), and 80b-6(4)] and Rule 206(4)-8 thereunder [17 C.F.R. §
19 275.206(4)-8].

20 **II.**

21 Permanently enjoin Defendants Block Bits Capital and Block Bits GP from directly or
22 indirectly, including but not limited to, through any entity owned or controlled by them,
23 participating in the issuance, purchase, offer, or sale of any security.

24 **III.**

25 Permanently enjoin Defendant Dillman from directly or indirectly, including, but not
26 limited to, through any entity owned or controlled by him, participating in the issuance,
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1 purchase, offer, or sale of any security, provided however, that such injunction shall not prevent
2 him from purchasing or selling securities for his own personal account.

3 **IV.**

4 Issue an order requiring Defendants Block Bits Capital, Block Bits GP and Dillman to
5 disgorge all ill-gotten gains or unjust enrichment derived from the activities set forth in this
6 complaint, together with prejudgment interest thereon.

7 **V.**

8 Issue an order requiring Defendants Block Bits Capital, Block Bits GP and Dillman to
9 pay civil monetary penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)],
10 Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 209(e) of the Advisers
11 Act [15 U.S.C. § 80b-9(e)].

12 **VI.**

13 Retain jurisdiction of this action in accordance with the principles of equity and the
14 Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and
15 decrees that may be entered, or to entertain any suitable application or motion for additional
16 relief within the jurisdiction of this Court.

17 **VII.**

18 Grant such other and further relief as this Court may determine to be just and necessary.
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21 Dated: April 27, 2022

Respectfully submitted,

22
23 /s/ Alice L. Jensen

ALICE L. JENSEN

Attorney for Plaintiff

SECURITIES AND EXCHANGE COMMISSION
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