SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN FRANCISCO

DEPARTMENT 304

JONATHAN SHOMRONI, individually and on behalf of others similarly situated,

Plaintiff,

v.

FEI LABS INC., a Delaware Corporation, JOSEPH SANTORO, an Individual, BRIANNA MONTGOMERY, an Individual, SEBASTIAN DELGADO, an Individual, and DOES 1-10,

Defendants.

Case No. CGC-22-598995

ORDER ON DEFENDANTS' DEMURRER TO PLAINTIFF'S COMPLAINT

The demurrer of Defendants Fei Labs Inc., Joseph Santoro, Brianna Montgomery, and Sebastian Delgado to Plaintiff Jonathan Shomroni's Complaint came on for hearing on September 12, 2022. The hearing was reported. Having considered the papers and pleadings on file in the action, and the arguments of counsel presented at the hearing, and good cause appearing therefor, the demurrer is overruled.

BACKGROUND[1]

On April 1, 2022, Plaintiff filed the Complaint (Compl.), a putative class action brought under Sections 5, 12 and 15 of the Securities Act of 1933 which seeks "to redress Defendants' offer and sale of

[1] This section summarizes Plaintiffs' allegations in the Complaint, the truth of which the Court assumes for purposes of Defendants' demurrer. Other pertinent allegations are referred to below.

digital assets in an unregistered securities offering that occurred between March 31 and April 3, 2021." (Compl. ¶ 1.) In particular, Plaintiff challenges Defendants' unregistered offer and sale of "FEI" and "TRIBE" digital tokenized assets through an initial Offering (which is also referred to as a "Genesis Event") of those assets, which raised the digital asset ETH or Ether from a Genesis Group of investors including Plaintiff and the putative class. (*Id.* ¶¶ 2, 26.)[2]

Plaintiff, a citizen of Israel, alleges that on April 3, 2021, he transferred 7 ETH, then valued at $2,009.19 per ETH, for a total value of $14,064.33, to Defendants' Offering, for which he received FEI tokens, all of which he "pre-swapped" during the Offering for 5,503.18 TRIBE tokens. (*Id.* ¶ 9.) He seeks to represent a class comprised of "All persons or entities who purchased the digital assets 'FEI' and 'TRIBE' in exchange for ETH as part of the Genesis Group, including those who 'pre-swapped' their Genesis Group FEI token allocation for TRIBE tokens between March 31, 2021 and April 3, 2021." (*Id.* ¶ 158.) In the Offering, Defendants raised approximately 639,000 ETH from approximately 17,000 addresses owned or controlled by Plaintiff and members of the Class. (*Id.* ¶ 35.)[3]

Defendant Fei Labs Inc. is "the entity that undertook the development of and employed the personnel who developed the Fei Protocol—the blockchain-based software application through which the Offering was conducted." (*Id.* ¶ 11.) It is a Delaware corporation with its headquarters in San Francisco, California. (*Id.*) It owns the software code and/or intellectual property rights to the Fei Protocol and its various components. (*Id.* ¶ 41.) Defendant Joseph Santoro is the Chief Executive Officer and a Director of Fei Labs, and one of the co-founders of the Fei Protocol. (*Id.* ¶¶ 12, 101-102.) Defendants Brianna Montgomery and Sebastian Delgado are each alleged to be one of the co-founders of the Fei Protocol and, on information and belief, an officer, director, shareholder, and/or agent of Fei Labs. (*Id.* ¶ 13-14, 103-104.) All three individual Defendants are also residents of San Francisco, where they were based prior to and through the time of the Offering. (*Id.* ¶¶ 12-14, 99.) Defendants collectively have disproportionate power over the FEI Protocol by virtue of owning between at least 22.4% to 31% of the voting power of the FEI Decentralized Autonomous Organization (DAO), a software protocol that can collect and deploy

[2] Plaintiff explains that ETH (or Ether), a cryptocurrency, is "the native digital asset of the Ethereum blockchain." (Compl. ¶ 9 fn. 2.)

[3] Assuming the same value per ETH as alleged for Plaintiff's investment, the Offering raised $1.278 billion.

digital assets,[4] and by controlling significant portions of the secondary market liquidity of FEI and TRIBE tokens. (*Id.* ¶¶ 23, 43.) Further, Defendants issued to themselves approximately 130 million TRIBE tokens prior to or as part of the Offering. (*Id.* ¶ 80.)

The ETH contributed by Plaintiff and the putative class in exchange for FEI tokens in the Offering was pooled inside a piece of trading software called "Protocol Controlled Value" (PCV), which is a pool of financial liquidity deployed by the Fei Protocol software to manage the trading price of FEI tokens on the secondary market. (*Id.* ¶¶ 60, 61.) Defendants deployed the PCV to the decentralized exchange "Uniswap," an order execution venue on the Ethereum blockchain. (*Id.* ¶ 63.) Uniswap is not registered with the SEC. (*Id.* ¶ 64.)

As part of the Offering, Plaintiff and other members of the putative class could elect to "pre-swap" or convert all or a portion of their expected FEI tokens into a separate "Initial DEX" or "Initial DeFi Offering" (IDO) conducted by Defendants. (*Id.* ¶ 86.)[5] The IDO was a sale and distribution of 200 million of the 1 billion TRIBE tokens that occurred on Uniswap immediately following the Offering. (Id. ¶ 88.) It evidently occurred simultaneously with the Offering. (*Id.* ¶ 89.)

Fei Labs conducted the Offering and issued both the FEI and TRIBE tokens. (*Id.* ¶ 100.) Defendants solicited Plaintiff and members of the putative class to invest in the Offering through various websites, by advertising the Offering through popular social media outlets and online chatrooms, and through numerous articles and online communications with investors. (*Id.* ¶¶ 107-151, 153-157.)

Plaintiff alleges two causes of action: (1) count I for violation of Sections 5 and 12(a)(1) of the Securities Act by selling unregistered securities; and (2) count II against the individual Defendants as control persons under Section 15 of the Securities Act. (*Id.* ¶¶ 166-182.) Defendant demurs to the Complaint on the ground Plaintiff fails to allege sufficient facts to constitute a cause of action. Defendant makes two primary arguments: (1) that Plaintiff does not adequately allege a domestic transaction subject to the federal securities laws; and (2) that Plaintiff cannot establish that any defendant is a statutory seller

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[4] See SEC Rel. No. 81207 (July 25, 2017), Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, at 1 [defining a DAO as "a term used to describe a 'virtual' organization embodied in computer code and executed on a distributed ledger or blockchain"].)

[5] Plaintiff explains that DeFi or Decentralized Finance protocols "allow their users to engage in a variety of transactions that mimic or closely resemble otherwise regulated transactions (including but not limited to lending, market making, exchange, and derivative products) using digital assets, blockchains, and so-called 'smart contracts,' mostly anonymously and online. (Compl. ¶ 18.)

under Section 12(a)(1). Defendant also contends that Plaintiff's control person claims against the individual Defendants fail for lack of a primary violation and insufficient allegations of control.[6] Plaintiff opposes the demurrer.

LEGAL STANDARD

A demurrer lies where "the pleading does not state facts sufficient to constitute a cause of action." (Code Civ. Proc., § 430.10(e).) A demurrer admits "all material facts properly pleaded, but not contentions, deductions, or conclusions of fact or law." (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318.) The complaint is given a reasonable interpretation, reading it as a whole and its parts in their context. (*Id.*) The Court accepts as true, and liberally construes, all properly pleaded allegations of material fact, as well as those facts which may be implied or reasonably inferred from those allegations; its sole consideration is whether the plaintiff's complaint is sufficient to state a cause of action under any legal theory. (*O'Grady v. Merchant Exchange Prods., Inc.* (2019) 41 Cal.App.5th 771, 776-777.)

DISCUSSION

I. Plaintiff Alleges A Domestic Transaction Subject to the Federal Securities Laws.

Section 12(a)(1) of the Securities Act, 15 U.S.C. § 77l(a)(1), provides a private right of action against any person who "offers or sells a security" in violation of Section 5 of the Act, which prohibits the offer or sale of unregistered securities. (15 U.S.C. § 77e.) Defendants contend that even if the FEI and TRIBE tokens are securities,[7] Plaintiff does not adequately allege a domestic transaction subject to the federal securities laws. (Opening Brief, 5-7.) The Court disagrees.

The federal securities laws generally do not apply extraterritorially.[8] In *Morrison v. National*

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[6] Defendants' Request for Judicial Notice is denied. Judicial notice of trial court rulings is improper, as such rulings have no precedential value. (*Bolanos v. Superior Court* (2008) 169 Cal.App.4th 744, 761.) The online article from Investopedia is not a proper subject of judicial notice. (Evid. Code § 452(h); see *Ragland v. US Bank National Assn.* (2012) 209 Cal.App.4th 182, 194 [declining to take judicial notice of the truth of contents of Web sites and blogs]; *In re Marriage of LaMoure* (2011) 198 Cal.App.4th 807, 826 [Wikipedia not a sufficiently reliable source].)

[7] Defendants dispute that the cryptocurrency tokens involved here are securities, but do not raise that issue on this demurrer. (Opening Brief, 1.) Accordingly, the Court expresses no view on that issue.

[8] There are certain exceptions to this general rule, but they are not pertinent here. (See *Securities and Exchange Commission v. Scoville* (10th Cir. 2019) 913 F.3d 1204, 1215-1218 [discussing 2010 Dodd-

Australia Bank Ltd. (2010) 561 U.S. 247, the U.S. Supreme Court held that the presumption against extraterritorial applicability of congressional legislation renders Section 10(b) of the Securities Exchange Act of 1934 applicable to deceptive conduct "only in connection with the purchase or sale of a security listed on an American stock exchange [or] the purchase or sale of any other security in the United States." (*Id.* at 273; see also *id.* at 267 ["it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies."].) The Court reasoned that "the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States." (*Id.* at 266.) Because the claims in *Morrison* concerned shares of common stock in an Australian bank that were not listed on a domestic exchange, "and all aspects of the purchases complained of by those petitioners who still have live claims occurred outside the United States," the petitioners failed to state claim upon which relief could be granted. (*Id.* at 273.)

It is common ground between the parties that the *Morrison* test applies here. (Opening Brief, 5-7; Opposition, 2-5.)[9] They differ, however, on its application. Defendant argues that the first prong of the test is not met because the digital tokens were not listed on an American stock exchange. (Opening Brief, 5.) Plaintiff does not take issue with that argument, but contends that his claims arise from "purchases and sales of securities in the United States." (Opposition, 2-5.) Defendants disagree, asserting that because the complained-of transactions took place on the Ethereum blockchain, "a distributed worldwide network," they cannot be said to have occurred within the United States. (Opening Brief, 5-7.) In the Court's view, Plaintiff has the better of the argument.

As the Ninth Circuit has observed, *Morrison* "did not describe the contours of this [domestic transactions] category at length." (*Stoyas v. Toshiba Corporation* (9th Cir. 2018) 896 F.3d 933, 947.) In *Stoyas*, the court adopted the "irrevocable liability" test previously applied by the Second and Third Circuits to determine when a securities transaction is domestic. (*Id.* at 948.) Under that test, "a plaintiff

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Frank Act, concluding that "Congress has 'affirmatively and unmistakably' indicated that the antifraud provisions of the federal securities acts apply extraterritorially when the statutory conduct-and-effects test is met"].)

[9] Although *Morrison* involved the antifraud provisions of the Exchange Act of 1934, courts have subsequently applied its holding to claims under the 1933 Act. (E.g., *In re Vivendi Universal, SA, Securities Litigation* (S.D.N.Y. 2012) 842 F.Supp.2d 522, 528-529 ["the Court determines that *Morrison*'s underlying logic counsels extending its holding to cover the Securities Act"].)

must plausibly allege 'that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security.'" (*Id.* at 948, quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto* (2d Cir. 2012) 677 F.3d 60, 68.) Alternatively, a plaintiff may allege "that title to the shares was transferred within the U.S." (*Id.*) In determining whether the test is satisfied, a court should look to "factual allegations concerning contract formation, placement of purchase orders, passing of title, and the exchange of money," which "are directly related to the consummation of a securities transaction." (*Id.* at 949.)

Here, Plaintiff alleges that Defendants are all residents of California, where Fei Labs has its headquarters and the individual Defendants reside. He further alleges that Fei Labs conducted the Offering and issued the tokens, utilizing a website hosted on a U.S. server at which Plaintiff and putative class members inputted their investments of ETH, thereby executing digital transactions that were irrevocably recorded on the Ethereum blockchain ledger maintained on computer systems and servers throughout the United States as well as worldwide. (Compl. ¶¶ 28-32, 100.) "Thus, Defendants incurred irrevocable liability within the United States to deliver FEI/TRIBE tokens to Plaintiff and the Class." (*Id.* ¶ 32.) Plaintiff alleges that a substantial percentage of the servers on which the transactions were processed are located in the United States. (*Id.* ¶ 169 [alleging that as of April 6, 2021, 37.35% of all Ethereum nodes, which validate transactions on the Ethereum blockchain, were located in the United States].)[10] Further, he alleges that the website through which he and members of the putative class were able to redeem the tokens were hosted on servers in the United States. (*Id.*) "Thus, the obligation to deliver FEI and TRIBE tokens purchased by Plaintiff and the Class during the Genesis Event was incurred in the United States, and actual delivery occurred in the United States." (*Id.*) Finally, Plaintiff alleges that Defendants engaged in extensive solicitation efforts in California, where all Defendants were based and from which they operated "prior to and throughout the time of the Offering." (*Id.* ¶ 99.)

These allegations are ample, in the Court's view, to establish a plausible basis for Plaintiff's allegation that the Offering was a domestic transaction subject to the federal securities laws. One federal court, for purposes of determining whether an Initial Coin Offering (ICO) constituted a domestic

[10] Plaintiff's assertion in his opposition brief that "the plurality of Ethereum nodes at the time were located in the U.S." (Opposition, 4) is not supported by any allegation in the Complaint.

transaction, framed the question before it—which is identical to the one posed here—as follows: "where does an unregistered security, purchased on the internet, and recorded 'on the blockchain,' actually take place?" (*In re Tezos Securities Litigation* (N.D. Cal. Aug. 7, 2018) 2018 WL 4293341, at *8.) On facts closely similar to those presented here, the court concluded that the plaintiff's purchase of securities in the ICO occurred inside the United States where, among other factors, the plaintiff participated in the transaction by using an interactive website that was hosted on a server in Arizona and run primarily by an individual defendant in California; he presumably learned about the offering and participated in response to marketing that primarily targeted United States residents; and "his contribution of Ethereum to the ICO became irrevocable only after it was validated by a network of global 'nodes' clustered more densely in the United States than in any other country. (*Id.*)[11]

Other courts have reached similar conclusions. (See, e.g., *Securities and Exchange Commission v. Scoville* (10th Cir. 2019) 913 F.3d 1204, 1226 [where defendant company was based in the United States and operated out of the United States when selling its securities over the internet through computer servers based in the United States, it "made several securities sales in the United States. That many [securities] buyers were abroad when they purchased the securities over the internet does not alter this conclusion." (Briscoe, J., concurring)]; *Stoyas*, 896 F.3d at 949 [where plaintiff funds alleged that defendants' principal executive offices, agents for service, and offices where security holders can exchange their shares were all in the United States, "an amended complaint could almost certainly allege sufficient facts to establish that [plaintiff fund] purchased its [securities] in a domestic transaction"]; *Securities and Exchange Commission v. Ripple Labs, Inc.* (S.D.N.Y. Mar. 11, 2022) 2022 WL 62966, at *12 [upholding jurisdiction over Section 5 claims against individual defendants for selling securities on digital asset trading platforms where certain platforms were incorporated in the United States, defendants executed offers and sales through accounts based in the United States, and the individual defendants resided in California during the time period in question].)

Here, as in these cases, "the Court may infer that [Defendants'] sales on that platform occurred in

[11] As partial support for its conclusion, the court cited a case "holding that where non-exchange listed securities are offered and sold over the internet, the sale takes place in both the location of the seller and the location of the buyer." (2018 WL 4293341 at *8 fn. 13, citing *Securities and Exchange Commission v. Traffic Monsoon, LLC* (D. Utah 2017) 245 F.Supp.3d 1275, 1296, *aff'd sub nom. Securities and Exchange Commission v. Scoville* (10th Cir. 2019) 913 F.3d 1204.)

the United States because irrevocable liability may attach when digital assets enter and leave those accounts," and that Defendants made offers from the United States by "direct solicitation via placement of [securities] onto the digital asset trading platforms." (*Ripple Labs*, 2022 WL 62966, at *12.)[12]

Defendants contend that cryptocurrency transactions that are conducted over a global distribution network consisting of blockchains resident on servers around the world cannot constitute domestic transactions unless all the nodes involved in the transaction are in the United States.[13] In other words, Defendants contend that in order to determine whether the federal securities laws applies to a given such transaction, a court must conduct a case-by-case factual inquiry into the physical location of the nodes on which the blockchain is resident.[14] Defendants' position is entirely unpersuasive, for at least two reasons.

First, one of the Court's primary concerns in adopting the transactional test in *Morrison* was to avoid "the interference with foreign securities regulation that application of [the federal securities laws] abroad would produce." (*Morrison*, 561 U.S. at 269 ["The probability of incompatibility with the applicable laws of other countries is so obvious that if Congress intended such foreign application it would have addressed the subject of conflicts with foreign laws and procedures. Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And the regulation of other countries often differs from ours as to what constitutes fraud, what disclosures must be made, what damages are recoverable, what discovery is available in litigation, what individual actions may be joined in a single suit, what attorney's fees are recoverable, and many other matters."].) Yet if Defendants' extreme approach were to be accepted, it would be possible that *no country's* securities laws would apply to a cryptocurrency transaction which utilizes worldwide computer networks. That result is hardly compelled by *Morrison*'s holding or

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[12] In *Ripple Labs*, the court rejected the contention that the individual defendants' offers and sales were "predominately foreign," observing that "[t]hese offers and sales were made by U.S. residents, involving alleged securities issued by a U.S. company, concerned at least some offers and sales made on U.S.-based platforms, and included at least some offers and sales made to U.S. purchasers. Thus the application of Section 5 to these offers and sales would enhance confidence in U.S. securities markets and protect U.S. investors." (*Id.* at *14 (cleaned up).) The same conclusion follows here.

[13] At the hearing, Defendants asserted that certain other cryptocurrency transactions—those that occur on centralized cryptocurrency exchanges and result in an entry on the exchange's ledger in the United States—would qualify as domestic transactions. Of course, the instant case involves an unregistered offering not listed on an exchange.

[14] When asked at the hearing where issuers of cryptocurrency resident on the blockchain *can* be sued, Defendants declined to give a straight answer and characterized the inquiry as "an interesting question." (See note 20, *infra*.)

rationale.[15]

Second, Defendants' position is irreconcilable with the SEC's interpretative guidance in this developing area, which is entitled to substantial deference from the courts. (*Chevron U.S.A., Inc. v. Natural Res. Def. Council* (1984) 467 U.S. 837, 865; *City of Arlington v. F.C.C.* (2013) 569 U.S. 290, 296.)[16] In a recent Report of Investigation, the SEC addressed a closely similar series of transactions in which a decentralized autonomous organization (DAO) sold digital tokens to investors in exchange for ETH, with the funds held at an Ethereum blockchain address associated with the DAO. The DAO was intended to be autonomous in that project proposals for use of the funds were in the form of smart contracts that exist on the Ethereum Blockchain and the votes were administered by the code of the DAO. At an offering held in 2016, the DAO offered and sold approximately 1.15 billion DAO tokens in exchange for a total of approximately 12 million ETH, which was valued at the time the offering closed at approximately $150 million. The DAO was formed by a German corporation and its co-founders, and its code was deployed on the Ethereum Blockchain as a set of pre-programmed instructions. The co-founders promoted the DAO by soliciting media attention and posting dates on websites and online forums relating to blockchain technology.

The SEC utilized its Special Report to issue an express caution against adopting a cramped understanding of the federal securities laws merely because of the use of emerging forms of technology:

> The Commission deems it appropriate and in the public interest to issue this report of investigation . . . to advise those who would use a Decentralized Autonomous Organization ("DAO Entity"), or other distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps

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[15] Nor is it supported by the Second Circuit's unreported summary order in *Banco Safra S.A.-Cayman Islands Branch v. Samarco Mineracao S.A.* (2d Cir. 2001) 849 Fed.Appx. 289, upon which Defendants heavily rely. In *Banco Safra*, which was not a cryptocurrency case, the plaintiff was the Cayman Islands branch of a Brazilian bank which purchased securities issued by "several offshore companies connected to a Brazilian mining operation" in secondary aftermarket transactions from counterparties or broker dealers located in the United States. (*Id.* at 291-292.) The court held first that the plaintiff bank's argument that using U.S. dollars and New York bank accounts to purchase the bonds was enough to establish a domestic transaction under Morrison. (*Id.* at 294.) Next, it held that plaintiff's allegations about the location of the counterparties and/or broker dealers were not sufficient, both because they were silent as to whether those parties acted as principals or instead as agents who merely facilitated the sale and purchase of the bonds between the parties, and also failed to allege that the agents "acted in the United States to incur liability for the sales." (*Id.* at 294-295.) It was not enough for plaintiff to provide those parties' generic U.S. addresses "without also listing where the individuals actually involved in negotiating the transactions were located when they negotiated the transactions." (*Id.* at 295.) Here, in contrast, Plaintiff *does* explicitly identify Defendants' locations within the United States when they conducted the Offering.

[16] Defendants candidly conceded at the hearing that they do not entirely agree with the SEC's analysis in its Special Report.

> to ensure compliance with the U.S. federal securities laws. All securities offered and sold in the United States must be registered with the Commission or must qualify for an exemption from the registration requirements. In addition, any entity or person engaging in the activities of an exchange must register as a national securities exchange or operate pursuant to an exemption from such registration.
>
> This Report reiterates these fundamental principles of the U.S. federal securities laws and describes their applicability to a new paradigm—virtual organizations or capital raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment and the related offer and sale of securities. *The automation of certain functions through this technology, "smart contracts," or computer code, does not remove conduct from the purview of the U.S. federal securities laws*. This Report also serves to stress the obligation to comply with the registration provisions of the federal securities laws with respect to products and platforms involving emerging technologies and new investor interfaces.

(SEC Rel. No. 81207 (July 25, 2017), Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, at 1-2 (emphasis added; footnotes omitted).) As the SEC made clear in that Report, the federal securities laws apply to various activities "without regard to the form of the organization or technology used to effectuate a particular offer or sale." (*Id.* at 10; see also *id.* at 18 ["These [registration] requirements apply to those who offer and sell securities in the United States, regardless whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology."].)

II. Plaintiff Sufficiently Alleges That All Defendants Are "Statutory Sellers."

Defendants' second argument is that Plaintiff fails to allege any Defendant can be termed a "statutory seller" within the meaning of the Securities Act. (Opening Brief, 7-13.) In particular, Defendants argue that Plaintiffs does not allege that any Defendant passed title to him for value or directly, actively, and successfully solicited his purchase. (*Id.*) The Court is unpersuaded.

As noted above, Section 12(a)(1) of the Securities Act makes actionable the offer or sale of any unregistered security in interstate commerce. (15 U.S.C. § 77l(a)(1).) Under the Supreme Court's decision in *Pinter v. Dahl*, Section 12(a)(1) liability "is not limited to persons who pass title" in an unregistered security, but also extends to "the person who successfully solicits the purchase" of such security, "motivated at least in part by a desire to serve his own financial interests or those of the security owner." (*Pinter v. Dahl* (1988) 486 U.S. 622, 643-647.) This statutory seller rule ensures that Section 12 "imposes liability on only the buyer's immediate seller; remote purchasers are precluded from bringing

actions against remote sellers. Thus, a buyer cannot recover against his seller's seller." (*Id.* at 644.)

Defendants argue first that Plaintiff has not alleged, and cannot do so, that they directly passed title to him because he "chose to engage in a self-executing transaction with the Fei Protocol." (Opening Brief, 8-9.) Defendants insist that Plaintiff's "counterparty in this transaction was the **FEI Protocol software** itself." (*Id.* at 9.) Defendants' unsupported argument, to put it as politely as possible, is risible. Software, no matter how complex, does not "offer" or "sell" securities; people (and the corporations and other business organizations they form) do, utilizing software as the *means* by which those transactions are effected. Likewise, "smart contracts" allow *parties* to define the terms of their transactions and provide for their execution.[17] Defendants' assertion that the Fei software was the "seller" of the alleged securities is akin to a car manufacturer attempting to avoid liability for an accident in which a self-driving car mows down a pedestrian by insisting that the vehicle's software is solely to blame.[18]

Here, Plaintiff alleges that the individual Defendants conceived and founded the Fei Protocol, that Defendant Fei Labs conducted the Offering and issued both the FEI and TRIBE tokens, and that Defendants had a direct financial interest in the Offering. As such, Fei Labs and the individual Defendants readily qualify as statutory sellers.

Thus, in *In re Tezos Securities Litigation*, the court found that two individual defendants and their company (together, DLS), which originally conceived of a blockchain project and posted on internet forums about their plan for an offering in which tokens would be allocated in exchange for initial investments, qualified as statutory sellers under the *Pinter* standard. The court found that although

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[17] "Although crypto-assets originated as a medium of exchange, the continued development of blockchain technology has allowed for several other uses for crypto-assets. One such use for blockchain technology is the so-called "smart contract," which essentially functions as an automated, secure digital escrow account. A smart contract allows the parties to define the terms of their contract and submit the crypto-assets contemplated in the contract to a secure destination. The smart contract then automatically distributes the crypto-assets to the appropriate party upon the satisfaction of the relevant conditions precedent defined in the smart contract." (*In re Bibox Group Holdings Limited Secs. Litig.* (S.D.N.Y. 2021) 534 F.Supp.3d 326, 330.)

[18] Defendants point out that the SEC's Special Report characterized the DAO involved in that case as an issuer of securities. (Report, at 16.) What they omit to mention, however, is that the SEC also emphasized that the definition of "issuer" is "flexibly construed in the Section 5 context as issuers devise new ways to issue their securities and the definition of a security itself expands." (*Id.* at 15 (cleaned up).) Thus, "those who participate in an unregistered offer and sale of securities not subject to a valid exemption are liable for violating Section 5." (*Id.* at 16.) Plaintiff adequately alleges that all named Defendants here participated in the unregistered offer and sale of digital tokens. Moreover, Plaintiff's allegations suggest that the DAO did not even come into existence until after the Offering.

defendants had formed a separate Swiss foundation to oversee the ICO, plaintiff had sufficiently alleged that the DLS defendants were statutory sellers because they had successfully solicited his ICO contribution and were directly involved in the overall offering:

> Reiterating his factual allegations concerning DLS' comprehensive involvement with the ICO's planning and execution, [plaintiff] effectively discredits any notion of DLS as a bit player. More to the point, he frames that involvement—including creation of the Tezos technology, establishment of a legal entity to monetize DLS' interest in that technology, development of a platform to facilitate said monetization, and minute-to-minute oversight of the monetization process itself—as rising well above the level of "collateral participa[tion]" in his and all other ICO transactions.

(2018 WL 4293341, at *9.) Accordingly, the court denied the defendants' motion to dismiss the plaintiff's Section 12 claim. (*Id.*; see also, e.g., *Balestra v. ATBCOIN LLC* (S.D.N.Y. 2019) 380 F.Supp.3d 340, 357-358 [in putative class action alleging violations of Securities Act arising out of selling of unregistered securities through initial coin offering of a digital asset, denying individual defendants' motion to dismiss Section 12(a) count where complaint contained numerous allegations indicating that co-founders of company engaged in steps necessary to the distribution of ATB Coins, including personal involvement in publicizing the ICO and promoting its launch, and stood to directly benefit from those sales; "These promotional statements trumpeting the potential of the ATB Coin and the ongoing opportunity to invest in the ATB ICO . . . clearly reflect both [defendants'] efforts to solicit the sale of ATB Coins."].) The same result follows here.

Defendants' heavy reliance on *Jensen v. iShares Trust* (2020) 44 Cal.App.5th 618 is misplaced. That case was brought by investors who purchased shares of exchange-traded funds (ETFs) against the issuers of the fund and associated entities. However, the plaintiffs did not purchase their securities in the initial offering, but rather on the secondary market. (*Id.* at 642.) As a result, the issue before the court was whether the named defendants had directly and actively participated in the solicitation of the immediate sale so as to ensure a direct relationship between the purchaser and the defendant. (*Id.* at 647; see also *id.* at 650 ["The complaint thus fails to allege the necessary direct and active participation in the solicitation of the immediate sale to hold the issuer liable as a § 12(2) seller, given that appellants purchased their ETF shares on the secondary market, not directly from respondents" (cleaned up).) However, *Jensen* continued to recognize that liability under Section 12 extends both to the immediate sellers of securities and "those who solicit purchasers to serve their own financial interests or those of the

securities owner." (*Id.* at 646 (cleaned up).)[19]

Jensen is distinguishable from the situation involved here, in which Plaintiff purchased the tokens in the initial Offering, which was conceived, undertaken and promoted by Defendants, and from which Defendants directly benefited financially by way of a distribution of tokens. In light of Defendants' direct involvement and financial interest in that Offering, it therefore is unnecessary for Plaintiff to show that they were personally involved in soliciting his investment. Indeed, in *Tezos*, the court expressly noted that the lead plaintiff did not allege "pre-contribution awareness of any of the defendant-specific promotional or procedural activity recounted above. He does not, in other words, claim to have read the [individual defendants'] posts [or] watched the Foundation's how-to video." (2018 WL 4293341, at *3.) As noted above, however, the court did not view such allegations as essential to establishing defendants' status as statutory sellers. So too here.

Moreover, it is far from clear that Defendants' apparent emphasis on the need for one-on-one or targeted solicitation is correct.[20] At least one federal appellate court has held squarely that "a person can solicit a purchase, within the meaning of the Securities Act, by promoting a security in a mass communication." (*Wildes v. BitConnect International PLC* (11th Cir. 2022) 25 F.4th 1341, 1345.) Rejecting the defendant's argument there that "liability follows only when a seller directs a solicitation to a particular prospective buyer," the court held that "nothing in the Securities Act makes a distinction between individually targeted sales efforts and broadly disseminated pitches." (*Id.*) As the Eleventh Circuit pointed out, neither the language of the Securities Act nor anything in *Pinter* limits solicitations to "personal" or targeted ones. (*Id.* at 1345-1346.) The court held that when the defendant promoters urged people to buy BitConnect coins in online videos, they solicited the purchases that followed, and that the plaintiffs therefore stated a Section 12 claim against the defendant promoters. (*Id.* at 1346.) As it explained,

> Technology has opened new avenues for both investment and solicitation. Sellers can now reach a global audience through podcasts, social media posts, or, as here, online videos and web links.

[19] Although *Jensen* involved Section 12(a)(2), the same standard applies to Section 12(a)(1). (*Jensen*, 44 Cal.App.5th at 646 fn. 19.)

[20] At the hearing, Defendants seemed to back off this position, but they never clearly explained why the extensive solicitation activities alleged in the Complaint are insufficient to state a claim or what, in their view, would comprise a "direct relationship" to such solicitation. In the Court's view, Defendants' hiding the ball does not amount to persuasive advocacy.

> But under the district court's cramped reading of the Securities Act, a seller who would be liable for recommending a security in a personal letter could not be held accountable fore making the exact same pitch in an internet video—or through other forms of communication listed as exemplars in the Act, like circulars, radio advertisements, and television commercials. That makes little sense. A seller cannot dodge liability through his choice of communications—especially when the Act covers "any means" of "communication." We decline to adopt an interpretation that both contradicts the text and allows easy end-runs around the Act.

(*Id.* (cleaned up.) "When a person solicits the purchase of securities to serve his (or the security owner's) financial interests, he is liable to a buyer who purchases those securities—whether that solicitation was made to one known person or to a million unknown ones." (*Id.* at 1347.) That language and holding is squarely applicable here.

III. Control Person Liability Is Adequately Alleged.

Plaintiff's control person cause of action under Section 15 in Count II is essentially derivative of the primary violation cause of action in Count I. The Court having overruled Defendants' demurrer to Count I, it also overrules their demurrer to Count II for control person liability. The Court finds Defendants' argument that Plaintiff's control allegations are insufficient to be unpersuasive. (See *Balestra,* 380 F.Supp.3d at 359 [plaintiff plausibly alleged that officers of company who were "integral to the launch of the ATB ICO" and played "leading roles in promoting the company's lone business product" possessed the power to direct the company's management and policies, and were therefore control persons under § 15(a)]; *In re Tezos Securities Litigation*, 2018 WL 4293341, at *11.)

CONCLUSION

For the foregoing reasons, Defendants' demurrer is overruled.

IT IS SO ORDERED.

Dated: September 16, 2022

Ethan P. Schulman
Judge of the Superior Court

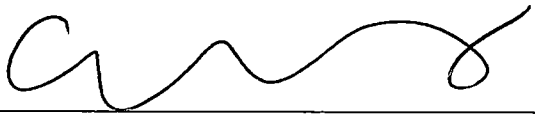
CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.251)

I, Ericka Larnauti, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On September 16, 2022, I electronically served the attached document via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: September 16, 2022

Mark Culkins, Interim Clerk

By: 

Ericka Larnauti, Deputy Clerk