# SECURITIES SIDEBAR

THE LATEST SECURITIES LITIGATION NEWS FROM BLOCK & LEVITON

## BLOCK & LEVITON PARTNER NATHAN COOK NOMINATED TO SERVE AS VICE CHANCELLOR OF DELAWARE COURT OF CHANCERY

Block & Leviton is proud to announce that our partner, Nathan Cook, was nominated on June 3, 2022 by Delaware Governor John Carney to serve as Vice Chancellor of the Delaware Court of Chancery. The Court of Chancery has operated continuously since 1793 and fewer than 50 people have held this job in that time. Block & Leviton congratulates Cook on this remarkable, well-deserved honor.

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## B&L FILES CASE AGAINST ELON MUSK FOR FAILING TO TIMELY DISCLOSE HIS ACQUISITION OF TWITTER STOCK TO SHOW NO ONE IS ABOVE THE LAW

While it might not always seem like it, the rules do apply to everyone, even the richest man in the world. Elon Musk violated clear-cut SEC guidelines when he delayed notifying the public that he had acquired a more than 5% interest in Twitter common stock. For days, Musk continued acquiring Twitter shares on the cheap–as soon as his interest in the company was disclosed, Twitter share price skyrocketed. Fortunately, Block & Leviton was first on the scene–filing a lawsuit against Musk on behalf of all those who sold their shares (many of whom sold to Musk himself) at a lower price than they would have if Musk had just followed the law.

The U.S. Securities and Exchange Commission ("SEC") requires owners of 5% of a publicly traded company to publicly disclose their ownership within 10 days of acquiring 5% of a company through a "Schedule 13" – a form that describes the purchases made and their purpose. Musk began gradually purchasing Twitter stock in January 2022, going over the 5% threshold on March 14. Under SEC rules, Musk was required to file his Schedule 13 on March 24. Instead, he waited until April 4, 2022, amassing an additional 4.1% of Twitter in that time. After Musk filed his Schedule 13, Twitter's stock went from $39.31 to $49.47 at the end of the next trading day.

In addition to violating securities regulations, Musk's late disclosure allowed him to acquire 4.1% of Twitter at a 27% discount, allowing him to began his play for control of Twitter in a far stronger position than he would have otherwise.

Unlike many frauds which center on misleading disclosures, exaggeration of good news, or downplaying bad news, here the theory of the case is simple and direct. Our lawsuit, *Rasaella v. Musk*, 1:22-cv-03026 (S.D.N.Y.) was filed in April; the lead plaintiff deadline is June 13, 2022.

Much of the news that has emerged since the filing of Musk's Schedule 13 has focused on the ever-changing nature of Musk's proposal to take Twitter private. First, Musk claimed he had no desire to buy the company at all, briefly agreeing to, then refusing a Board seat on the Company. Then, he made an offer

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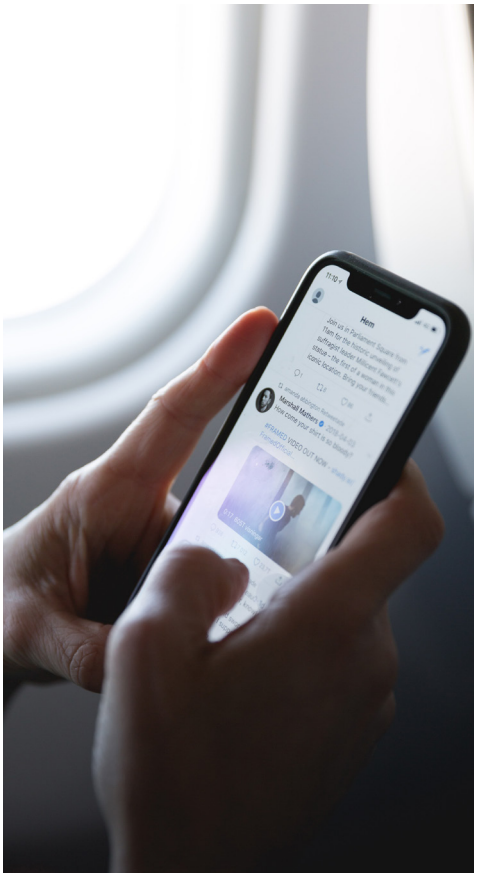

to take Twitter private at $54.20 per share. Twitter's Board voted to accept this offer and signed a purchase agreement with Musk on April 25, 2022. Since the signing of the agreement, the purchase has been mired in public drama usual for a major corporate acquisition.

Twitter filed its initial Proxy for the take-private transaction with Musk on May 16, 2022. In the Proxy, Twitter disclosed that Musk spoke with members of the Board about the potential to take Twitter private on March 30, 2022, six days after he was obligated to disclose his over 5% ownership stake, yet still days before he filed his Schedule 13. That Musk was already considering and communicating a desire to take Twitter private to Twitter's Board as he continued to acquire Twitter shares without disclosing this to the public lends significant support to the idea Musk's late disclosure was a deliberate attempt to acquire shares at a discount for as long as possible to make the eventual purchase easier and cheaper.

The SEC apparently agrees: it sent Musk a letter on April 4, 2022 asking for additional information on what caused him to submit his Schedule 13 when he did. The letter was disclosed on May 27, 2022, and further action may be pending.

We hope our case can show that no one—not even Elon Musk—is above the law, and that there are consequences to be paid for violating laws meant to protect everyday investors. We fully anticipate this action will proceed to trial, and hope to recover on behalf of those who lost out due to Musk's actions.

MAY 31, 2022
ESG INVESTMENT UPDATE

## S&P 500 ESG INDEX DROPS TESLA, KEEPS EXXON

The S&P 500 ESG Index is a broad-based, market-cap-weighted index designed to measure the sustainability of securities based on their performance across a variety of environmental, social and governance (ESG) issues. The index underwent its fourth annual rebalance in May – dropping Tesla but keeping ExxonMobil. Elon Musk responded to the change on Twitter, calling ESG "a scam."

At first glance, the decision is somewhat baffling. So how is it that one of the world's largest oil and gas companies comes out looking better when it comes to ESG than an electric car manufacturer? The answer is that S&P's evaluations of ESG performance are more nuanced thanyou might expect, especially if you're inclined to think the whole thing is little more than a marketing ploy for the firm included in the index.

The S&P 500 ESG Index was launched on January 28, 2019. S&P's methodology for evaluating firms for potential inclusion in the ESG Index involves a complex review of the companies included in the S&P 500 across a range of factors. Some kinds of firms, like arms manufactures and companies linked to violations of international law, are categorically excluded. Others are evaluated based on their policies, practices, and impact. While the measures used by the index to evaluate the performance of publicly traded companies have changed somewhat over time, the growth of sustainable investing more generally has been facilitated by the willingness of S&P, among others, to use specific evaluations of ESG factors as a benchmark for inclusion in a popular investment vehicle.

Two components of S&P's methodology make sense of the Tesla/Exxon kerfuffle. First, S&P's evaluations are conducted on an industry-by-industry basis based on the Global Industry Classification Standard, not on an index-wide basis. So comparing Tesla to Exxon is apples to oranges, because the two companies were evaluated based on how they compare to their competitors on ESG, not to one another. Perhaps unsurprisingly, when it

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comes to measures of environmental impact, automobile manufacturers as a group, are way ahead of oil and gas companies as a group. Tesla faced stiff competition from other automobile companies across a variety of ESG factors and, despite their juxtaposition in headlines, was never able to benefit from comparisons to companies that operate in other industries, like Exxon.

The second factor contributing to Tesla's absence from the ESG Index relates to shortcomings that are more specific to Tesla itself. Tesla underperformed in few categories where it could easily do better. For example, the firm lacks a specific Low Carbon strategy and scored poorly on measures of codes of business conduct because of a lack of transparency when it comes to reporting on things like occurrences of corruption, bribery, or anti-competitive practices. In addition, Tesla lost ground as a result of two separate events centered around claims of racial discrimination and poor working conditions at the company's Fremont factory, as well as its handling of the National Highway Traffic and Safety Administration's investigation of deaths and injuries linked to Tesla's vehicles operating on autopilot.

Faced with these kinds of headwinds, and public rebuke, one could easily imagine a firm putting out a press release announcing a renewed commitment to improving its safety record and working conditions while forthrightly addressing claims of discrimination. Dismissing the whole methodology underlying the Index as a scam may have felt easier in the heat of the moment. The good news for Tesla is that S&P's ESG Index gets regularly rebalanced. There's always next year.

## TOKEN FOR A RIDE: CRYPTO'S COLLAPSE AND BLOCKCHAIN LITIGATION

In November, Crypto.com acquired the naming rights to the former Staples Center, home of the Los Angeles Lakers, for $700 million. Not long thereafter, Superbowl LVI, which incidentally also took place in L.A., featured commercials starring Hollywood actors like Matt Damon and Larry David encouraging everyday Americans to buy into the crypto craze. What had been a fringe experiment in decentralized currency was gaining a measure of traction, not necessarily for its intended purpose but rather as an investment vehicle. Put simply, despite longstanding skepticism, crypto currency had sustained its momentum and consequently was enjoying a moment. The Lakers, meanwhile, had entered the season with title aspirations, having recently paid a premium to bring in an aging super star and former league MVP, ignoring widespread skepticism from commentators that his peak was behind him. SEC Chair Gary Gensler, meanwhile, was warning that crypto's run of success was creating dangerous expectations. "Right now, we just don't have enough investor protection in crypto," he said in an August 2021 speech. "Frankly, at this time, it's more like the Wild West. . . . If we don't address these issues, I worry a lot of people will be hurt."

In both cases, the pessimists were soon proved correct. The Lakers cratered in the early months of 2022 and missed the playoffs altogether. Their corporate patrons followed them downwards as crypto currencies across the board suffered loss after loss as macroeconomic trends caused crypto tailwinds to shift, before collapsing altogether in May when a pair of upstart cryptocurrencies (Luna and the "stablecoin" TerraUSD) became virtually worthless in a matter of days. On their way down, the two digital tokens in turn deflated the speculative bubbles propping up more well-known instruments like Bitcoin and Ethereum, which are now down approximately 60%. All told, since Crypto.com stamped its name on the Lakers' arena in November 2021, more than $1.5 trillion in value has been wiped out. The pain is largely being felt by retail investors who bought into crypto at its peak, lured in by the legitimacy crypto exchanges had bought with naming rights and celebrity endorsements.

Investors understandably may wonder if traditional securities law can offer relief. Crypto is an evolving

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legal landscape. All told, crypto has generated over 200 private lawsuits, with over half being filed in the past two years alone. For the most part, crypto litigation involves claims regarding consumer or commercial claims, rather than securities. For example, in January, purchasers of EthereumMax tokens brought suit against a crypto issuer and its celebrity endorsers, Kim Kardashian, Floyd Mayweather, Jr., and former NBA star Paul Pierce, alleging that the defendants engaged in a scheme that involved hyping the tokens on social media without disclosing the celebrities' financial stake in the crypto offering. The suit alleges violations of California competition and consumer law, rather than federal securities violations.

Securities claims have been rarer, but there are signs that these sorts of actions are increasing. While 11 crypto securities class actions were filed in all of 2021, 8 such suits have been filed already in 2022. More are likely to follow the current collapse.

Securities suits usually accuse crypto firms of selling coins that amount to "securities" without properly registering them with the SEC. The SEC has brought several actions alleging that certain crypto assets constitute unregistered securities, including one case that resulted in a $100 million settlement earlier this year, and another which advanced past a motion to dismiss in March concerning one of the world's largest cryptocurrencies. Investors have also brought private actions with the same theories, although one class action failed at trial in November 2021 when a jury concluded that a collection of related cryptocurrencies were not securities, and that the defendant therefore could not be liable for securities fraud. In May, Coinbase filed a motion to dismiss a class action on the grounds that the cryptocurrencies traded on its exchange are not securities.

Beyond the threshold question of whether any given cryptocurrency is a "security" at all, there are other complications to bringing a crypto class action. Block & Leviton is one of the few firms that has successfully sought recovery on behalf of crypto investors . In 2020, defendants in In re Tezos Securities Litigation agreed to repay investors $25 million to settle claims that their token offering constituted an unregistered securities offering. This success, one of just a small handful of private crypto securities settlements and one of just two multi-million dollar settlements, was hard fought and offers lessons on the difficulties of litigation in this area.
For one thing, cryptocurrencies often have foreign origins, creating jurisdictional and venue problems that do not typically arise in actions over traditional securities trading on U.S. exchanges. The Tezos Foundation, for example, was based in Switzerland and tried (unsuccessfully) to argue that the case was improperly brought in the United States. Another possible complication is that even if cryptocurrencies are securities, it may be harder to show that they trade in an efficient market. Establishing that a security trades in an efficient market, meaning that all publicly available information is reflected in the security's price, is essential for most securities class actions. Recent research suggests that while early volatility in cryptocurrency prices was driven by irrationality, the market overall has become far more efficient in recent years, at least with respect to large, established tokens like Bitcoin.

Even getting past these hurdles doesn't guarantee success, however. Cryptocurrencies are not generally backed by any real assets, unlike traditional securities, so plaintiffs face a real danger of being unable to collect on a favorable judgment. Such was the case in May 2020 when ATBCoin notified a federal court that it was no longer able to pay the $250,000 settlement it had agreed to just a month earlier.

Congress and the SEC have indicated that new rules and regulations may be on the way to bring order to the "wild west" of digital assets. Perhaps these changes will clear a path for investors, like those who have suffered mightily in the past few months, to recover some of their losses. For now, though, crypto litigation is rife with just as much peril as opportunity, not unlike cryptocurrencies themselves.