DECEMBER 2022

SECURITIES SIDEBAR

THE LATEST SECURITIES LITIGATION NEWS FROM BLOCK & LEVITON

WISHING YOU A HAPPY 2023!

Seasons Greetings!

We thank our clients for what has been a truly fantastic and successful 2022. Block & Leviton led numerous cases to a successful resolution, and have pressed to hold those responsible for corporate wrongdoing to account. We proudly watched our partner Nathan Cook appointed to Vice Chancellor at the Delaware Court of Chancery, and welcomed Kim Evans to lead our Delaware office. We've developed amazing partnerships, and look forward to continuing our work together in the coming year. Best wishes for happy holidays and a magnificent 2023!

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HISTORY REPEATING? MARKET CRASHES OFTEN REVEAL SECURITIES FRAUD

With more than half of economists expecting a U.S. recession in 2023, a look back at past crashes, crises, and contractions may provide timely insight as to what to expect in the world of securities litigation as investors prepare to batten down the hatches. The pattern is clear—as markets contract, inefficiency, incompetence, and fraudulent schemes often come to light, the flotsam and jetsam of the economy's ebb tide.

The burst of the dotcom bubble, for example, spurred the collapse of WorldCom, one of the biggest bankruptcies in the history of the United States. Led by CEO Bernie Ebbers, famous for sporting a ten-gallon hat and cowboy boots, WorldCom had become one of America's leading long-distance phone companies by conducting one acquisition after another. At the peak of the dotcom bubble, WorldCom's market capitalization had grown to $175 billion.

Then the music stopped. The Nasdaq fell by 75% between March 2000 and October 2002. Even as companies like Pets.com and Webvan declared bankruptcy and shuttered, few realized that the tech bust would reach a company as big as WorldCom. But the precipitous drop in the market caused WorldCom's fraud to bubble to the surface as declining spending on telecom services prompted Ebbers' increasing reliance on a rash of accounting tricks to maintain the appearance of continued profitability.

As the truth emerged, Ebbers was forced to step down as CEO. Shortly after Ebbers left WorldCom in April 2002, it was revealed that he had borrowed $408 million from Bank of America to cover margin calls, using his WorldCom shares as collateral. The company didn't weather the storm. WorldCom filed for bankruptcy on July 21, 2002. In 2005 Ebbers was convicted of securities fraud and sentenced to 25 years in prison.

The aftermath of the 2008 financial crisis, by contrast, featured a notable dearth of criminal convictions for prominent CEOs. Some have argued that the parties most responsible for the fraud underlying the 2008 financial crisis were bailed out, not prosecuted. Unsurprisingly, the SEC has a different perspective and devotes several pages on its website to cataloguing SEC enforcement actions "addressing misconduct that led to or arose from the financial crisis."

Prominent examples include a 2010 settlement in which Goldman Sachs agreed to pay a record $550 million following SEC charges that the firm defrauded investors by misstating and omitting key facts about financial products tied to subprime mortgages. Similarly, in October 2011, the SEC secured a $285 million settlement with Citigroup's principal U.S. broker-dealer subsidiary following allegations concerning misleading investors about

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a $1 billion CDO tied to the housing market in which Citigroup bet against investors as the housing market showed signs of distress. And J.P. Morgan resolved two successive SEC matters for similar conduct, paying $153.6 million in 2011 for misleading investors in a complex mortgage securities transaction just as the housing market was starting to plummet, and $296.9 million in 2012 for misleading investors in offerings of residential mortgage-backed securities. In each case, the pressure of the broader economic contraction made the underlying fraud impossible to conceal.

The COVID crash had a similar effect. In May the SEC charged Allianz Global Investors U.S. LLC and three former senior portfolio managers with fraudulently concealing the immense downside risks of a complex options trading strategy they called "Structured Alpha." According to the SEC, 2020 COVID-related market volatility revealed that AGI US had misled investors about the fund's level of risk, and that the individual defendants went to great lengths to conceal their fraud, including providing false testimony to regulators and conducting meetings in vacant construction sites to discuss sending assets overseas. The crash made the truth impossible to hide. AGI US and its parent company, Allianz SE, ultimately agreed to pay more than $1 billion to settle with the SEC and agreed to provide over $5 billion in restitution to victims.

If past is prologue, a recession next year seems likely to reveal fraud that has gone undetected thus far. Arguably, however, the implosion of the cryptocurrency space has already given rise to the biggest fraud stories of the day. Cryptocurrency exchange FTX, for example, filed for bankruptcy on November 11, 2022 and is facing scrutiny from U.S. authorities, as well as a wave of lawsuits, after it was revealed that $10 billion in customer assets were shifted from the exchange to founder Sam Bankman-Fried's trading company Alameda Research and that more than $1 billion in customer funds are, apparently, missing. Bankman-Fried's personal fortune, once estimated to be more than $30 billion, seems to have almost completely evaporated.

In an odd parallel to the height of the dotcom boom, FTX paid millions to air commercials during Super Bowl LVI just months before its collapse. As Mark Twain is reputed to have said, "history doesn't repeat itself, but it often rhymes."

NIKOLA CEO TREVOR MILTON CONVICTED OF STOCK FRAUD IN NEW YORK CRIMINAL TRIAL

On October 14, 2022, a Manhattan federal jury, having deliberated for only five hours after four weeks of testimony, found Trevor Milton, the former CEO of Nikola Motors, guilty of securities and wire fraud. The speedy verdict capped a two-year prosecution that saw Milton become the most prominent face of corporate malfeasance since Elizabeth Holmes.

When Nikola Motors went public via a SPAC merger on June 3, 2020, it was seen by many investors as the next Tesla; Trevor Milton made sure of it. Where Tesla made its fortune building electric cars for the average, if wealthy consumer, Nikola claimed to be building and selling commercial trucks that ran on either hydrogen or batteries. While companies have experimented with using hydrogen as a fuel source for years, it had never been cost-effective compared to fossil fuels. Hydrogen can be made either by running an electrical current through water – a process called electrolysis – or by breaking down natural gas into its constituent molecules. Both are energy intensive and expensive. Milton, both in the months leading up to Nikola going public and in the months after, claimed Nikola had solved the problem by making hydrogen from renewable energy and mass purchases of electricity from utilities. In Milton's telling, on the day Nikola went public, it was building hydrogen stations, making hydrogen fuel cheaply, and selling trucks that ran on hydrogen.

For the first three months after going public, Milton made increasingly brash claims about Nikola's business and products. For several weeks this made Nikola's stock price so high it had a larger market capitalization than Ford. This sort of serial promotion was not new for Milton, who had been overpromising to private investors since the unveiling of what he claimed was a functioning "Nikola One" prototype in December 2016. All the exaggerations came to an abrupt end with the publication of a short seller report by Hindenburg Research.

The report, issued in September 2020, claimed Milton had regularly lied about every aspect of Nikola's business. Among other things, it detailed how the Nikola One, listed as a product on Nikola's website and securities filings, was never a functioning truck; claimed how Nikola had never produced hydrogen, demonstrated how most of its touted 15,000 truck orders were cancellable and fully refundable, and revealed how Nikola's recently announced passenger pickup truck, the Badger, was little more than concept art. Nikola's stock cratered. Subpoenas from the Department of Justice and the SEC followed quickly. While Nikola cooperated with the DOJ and settled with the SEC months later without admitting or denying guilt, Milton maintained the Hindenburg report was self-interested lies looking to profit off a stock price drop.

The sometimes farcical details of the misstatements surrounding Nikola – the pickup truck the company was "accepting reservations" for that did not even have a working prototype; a so-called "in motion" YouTube video for the Nikola One made by putting it in neutral and rolling it down a hill - have been irresistible fodder for reporters. **CNBC made Trevor Milton the subject of an episode of American**

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Greed, featuring B&L's managing partner Jeff Block. The Wall Street Journal released a multi-episode podcast around Milton and Nikola.

Nikola executives were part of the tenwitnesses the government called in their prosecution of Milton. Both then-current Nikola CEO Mark Russell and CFO Kim Brady testified that Milton was a serial exaggerator, who made comments in podcasts, TV interviews, and on Twitter without grounding in fact, or corroboration from others at Nikola. Investors who listened to Milton's regular pronouncements on social media testified to how important his statements were to their decision to invest. People who worked with Nikola described how little original engineering and production work went into products that were ostensibly proprietary technology.

Though many of the facts surrounding Milton and Nikola were broadly known to the public before the trial, the case still had several interesting revelations. A Nikola contractor who served as a source for Hindenburg testified at trial Milton told him he did not "give a f*** about the environment" despite the image Milton projected for Nikola and its business. A GM engineer who worked with Nikola testified the Badger would have been fully designed and built by GM had it gone forward. Nikola executives revealed that statistics Milton used on social media and in interviews to describe current Nikola capabilities had come from projects given to private investors from before Nikola was public. Those same executives also claimed that they and others were so concerned about Milton's repeated misstatements to investors they threatened to resign en masse.

In the end, jurors convicted Milton on onecharge of securities fraud and two charges for wire fraud. Sentencing will occur in January 2023. **Though the government decided not to charge Nikola or its executives criminally, B&L is co-lead counsel on the case pursuing securities fraud claims against Nikola, many of its current and past executives, and Milton.**

JEFF BLOCK ON CNBC'S AMERICAN GREED

ESG UPDATE–NEW RULES PROPOSED BY THE SEC

The SEC proposed three new rules this year regarding environmental, social, and governance ("ESG") disclosures. The proposed rules come at a time when investors and politicians have turned towards ESG with considerable interest. According to Morningstar, investments in "sustainable" funds and ETFs have tripled in the last four years, from $700 billion in 2018 to $2.5 trillion as of June 2022.

The SEC's 2022 rule proposals primarily target "greenwashing" – the practice of overstating one's ESG credentials to attract investors – by establishing and enforcing unified standards for reporting. The SEC proposed the first ESG rule in March, which would require companies to disclose their greenhouse gas emissions and any "climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition." The second rule, proposed in May, would require funds that claim to be pursuing ESG strategies to provide much more detailed information about those strategies in their public filings. For example, a fund that touts environmental priorities would have to disclose the overall carbon emissions of its portfolio. The third rule, also proposed in May, amends the "Names Rule" to require funds with names suggesting that they focus on ESG factors to devote at least 80% of their value to investments with ESG characteristics.

"These rules would help provide comparability and consistency, but most importantly, would require funds and advisers to stand behind their ESG claims," SEC Commissioner Jaime Lizárraga said last month.

Yet what started out looking like a milestone year for ESG has turned substantially hazier as ESG increasingly becomes a polarizing political issue. Former Vice President Mike Pence called ESG a "pernicious strategy" in May, and at a hearing in September, Senator Pat Toomey (R-PA) accused SEC Chair Gary Gensler of trying to provide "climate activists with data to run political pressure campaigns against companies."

Red states are now mounting anti-ESG campaigns of their own. In October, Louisiana pulled $794 million in pension funds from BlackRock, citing the asset manager's "support of ESG investing." Missouri followed suit two weeks later, pulling the $500 million it had invested with BlackRock. Several states have enacted anti-ESG legislation or are poised to do so. Texas led the charge in 2021 when it passed a bill banning any companies that boycott the fossil fuel or firearm industries from contracting with the government. Kentucky, Oklahoma, and West Virginia passed similar laws, and nearly a dozen more states are

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considering doing the same. Arizona, Indiana, and Florida, meanwhile, have all made it unlawful to consider ESG factors when determining where to invest the states' funds.

Some private funds have also emerged to cater to anti-ESG tastes which, for example, make a point of investing in oil and gas or shun companies that advocate for LGBTQ rights.

What effect this backlash ultimately will have remains to be seen. ESG has already drilled out a foothold in the market because investors who control over a hundred trillion dollars in assets have demanded it. 92% of S&P 500 companies currently publish ESG reports, and thousands of companies have already agreed to disclose their carbon emissions. The SEC has said it is still reviewing the tens of thousands of public comments it received on the proposed ESG rules. What it will do, when, and whether it will survive the current Supreme Court is all up in the air.

PICKING UP THE SIGNAL: KEEPING PACE WITH SHIFTING PATTERNS OF COMMUNICATION

M&A litigators of a certain vintage often wax nostalgic about the pre-email era. It was—if you believe the stories—a simpler, better time. People got their news from the New York Times, not Twitter. There was no Uber, so children walked two miles to school, uphill both ways. And discovery in a high-profile M&A dispute might consist of a single banker's box of paper documents: a proxy statement, some formal Board minutes, and, maybe, a few handouts from investment bankers.

You'll never hear a shareholder lawyer—no matter how old—who shares in that nostalgia. As the courts have recognized (though too infrequently), these formal materials were all heavily lawyered. In even the most corrupt, conflicted transaction, the "surface of events ... in most instances, will itself be well-crafted and unobjectionable.[1]"

In the twenty-first century, however, the widespread adoption of email and e-discovery has allowed stockholder lawyers to "disturb[] the patina of normalcy" by uncovering more candid, contemporaneous communications from deal participants that shed light on the true story.[2] Multiple generations of M&A litigators have now been schooled in the nuances of email discovery. But two related trends threaten the viability of that approach and will require both lawyers and judges to make rapid adaptations.

The first development that threatens the viability of an email-first litigation strategy is a broader, macro shift to other forms of electronic communication. Boomers are retiring in droves and the workforce is increasingly dominated by Millennials and Gen Z—people who see email as an archaic, dying technology.[3] In many workplaces, email has been replaced by Slack. Conversations often happen over messaging apps, such as iMessage, WhatsApp, or Signal and work gets done in shared Google documents rather than multiple email exchanges attaching updated Word or Excel documents.

The second, more concerning development is a growing awareness among sophisticated financial actors that (1) conflicted transactions will be litigated and (2) emails get produced in litigation. It appears that years of jokes that the "e" in email stands for "evidence" have finally sunk in.

In response, sophisticated players have moved to other methods of communications for particularly sensitive messages. In 2022, the SEC imposed approximately $1.8 billion in fines on sixteen prominent banks and brokerages who had allowed employees to communicate through texting, WhatsApp, and other private channels of communication in an attempt to evade the attention of internal compliance professionals and outside regulators.[4] In the high-profile Twitter v. Musk litigation, Chancellor McCormick of the Delaware Court of Chancery warned that she might impose evidentiary sanctions on Elon Musk for failing to preserve messages sent through Signal, an ephemeral messaging app that allows users to enable auto-deletion of messages after a certain interval.[5]

Despite these prominent examples, it is still all-too-common for defense lawyers to resist the collection and production of text messages in litigation. As Chancellor McCormick observed in another matter, document custodians will inevitably deny using text messages in an initial interview with counsel: "because the question is asked at a time when a custodian is seeking to produce as little as possible, and what is often the music to a defense attorney's ears is, the answer is typically: 'No, I didn't text. Why would I do that? It was probably not substantive. It's so informal.'"[6]

As Chancellor McCormick went on to note, defense attorneys have an ethical obligation to "push harder on their clients to evaluate and check whether they used text messages for substantive communications."[7] But that obligation is too frequently honored only in the breach. As a consequence, the burden falls on stockholder-plaintiffs and their counsel. It is imperative for shareholders and their lawyers to develop a strategy to make sure that all possible sources of electronic communications ultimately end up in the record at trial.

Below are some best practices:

- Start The Conversation Early. Given the defense bar's typical resistance

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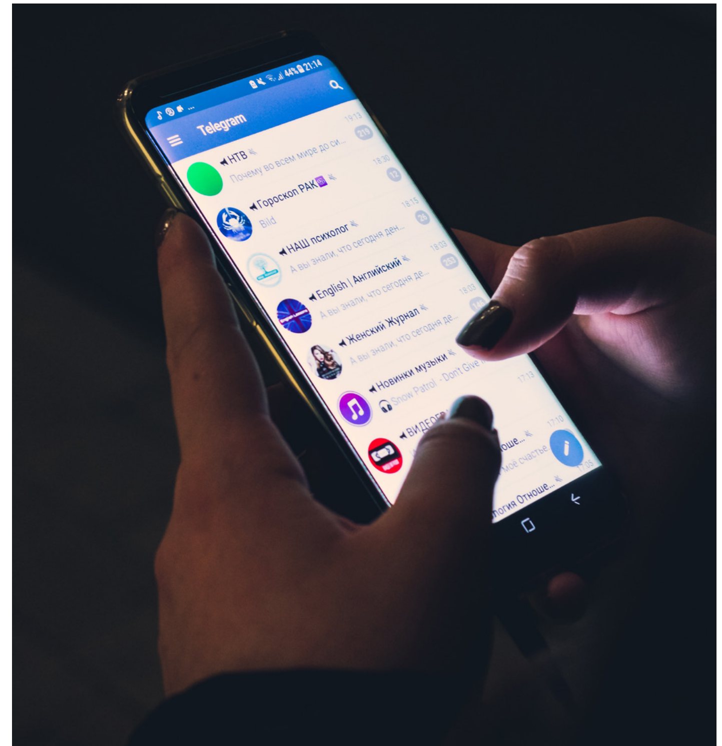
to producing text messages, plaintiffs will often have to file a motion to compel and obtain a Court order before they can gain access to texts. In order to win that motion, it's important to build a record early and often. Stockholder-plaintiffs should serve document requests that seek text messages, serve interrogatories that ask whether custodians text, and document in written meet-and-confer correspondence that they believe text messages will be an important source of information.

- Seek Discovery From Third Parties. Third parties, who don't perceive themselves as being at risk of being sued—are often more candid in internal communications, including about channels of communication. In Twitter, for example, Twitter was able to prove that Musk was communicating by Signal because a third-party produced a screenshot of a message from Musk, which included an icon indicating that Musk had his messages set to auto-destruct.
- Search The Email Record For Evidence of Texting. References to texting can often bubble up in anodyne emails that do get produced. In the Madison Square Garden Entertainment litigation, for example, we were recently able to prevail on a motion to compel seeking texts from members of the company's controlling family (the Dolans) based on a handful of references to texting in emails that contradicted Defendants' denials in their interrogatory responses.[8]

Every situation is different. And there are no guarantees that even the most aggressive discovery campaign will be able to turn up messages that the participants immediately deleted or otherwise took steps to keep hidden. But with a lot of persistence, and a little luck, dedicated plaintiffs' lawyers are often able to uncover enough evidence to allow the fact-finder to fill in the gaps and draw the necessary inferences to award a recovery to investors .



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[1] In re Fort Howard Corp. S'holders Litig., 1988 WL 83147, *12 (Del. Ch.).

[2] In re Del Monte Foods Co. Shareholders Litig., 25 A.3d 813, 817 (Del. Ch. 2011).

[3] Sophia June, Could Gen Z Free the World From Email?,NEW YORK TIMES (July 10, 2021).

[4] Sridhar Natarajan, et al., Wall Street Hit With $2 Billion of Fines in WhatsApp Probe, BLOOMBERG (Sept. 27, 2022).

[5] Twitter, Inc. v. Musk, 2022 WL 5078278, *5 (Del. Ch.).

[6] In re CVR Refining, LP Unitholder Litig., C.A. No. 2019-0062-KSJM (Del. Ch. Apr. 5, 2021) (Transcript) at 42.

[7] Id.

[8] In re Madison Square Garden Entertainment Corp. S'holders Litig., C.A. No. 2021-0468-KSJM (Del. Ch. Sept. 6, 2022) (Transcript) at 17 ("there was an initial custodian interview where the custodian said we don't use text to communicate about business in any way. And that's almost always what you hear in custodian interviews, right. And then the plaintiffs found a few emails suggesting that, in fact, there were texts sent to these custodians concerning business. And granted, these emails don't reflect that the texts would have been something they were totally interested in, but it did give them pause and suggests that, in fact, the initial representation in the custodial interview was inaccurate. So their request is that you go now and look at these repositories of information to see whether there are relevant documents within them. That's not unreasonable.")