

## SEC SETTLES WITH ELON MUSK AND TESLA OVER TAKE-PRIVATE TWEETS

Elon Musk's August 7, 2018 tweets, in which he had "secured" funding to take Tesla private at a substantial premium over the then-current share price, produced a storm of controversy and a series of securities class action lawsuits against him and the company. The Tesla CEO's tweets also led to an SEC enforcement action, in which the agency alleged that Musk's statements in the tweets were "false and/or misleading" because "he did not have an adequate basis in fact for making these assertions." Two days after the SEC filed its complaint, the SEC announced that it had entered a settlement with Musk as well as with Tesla, in which Musk agreed to step down as the company's Chairman. Further, the company agreed to appoint two independent directors, and both Musk and Tesla agreed to pay penalties of \$20 million each.

### BACKGROUND

During the trading day on August 7, 2018, Musk issued a series of tweets in which he not only said that funding for the take private transaction was secured, but that the only thing remaining in order for the transaction to be completed was a shareholder vote (implying that it had already been approved by the company's board of directors).

The SEC's complaint against Musk alleges that he did meet on July 31, 2018 with representatives of a sovereign wealth fund, in which, among other things, a possibility of a take private transaction was raised. However, the SEC alleges that the July 31st meeting lacked discussion of even the most fundamental terms of a proposed going-private

transaction. The discussion did not include any dollar amount or specific ownership percentage for the transaction; the fund's available liquid capital; any regulatory hurdles; or the process for securing board approval. Musk later acknowledged that no specific term deals were discussed at the meeting, and that nothing was exchanged in writing. Musk did not meet with the fund representatives again until August 10th, three days after his August 7th Twitter storm.

The complaint also alleges that on August 2nd, Musk sent the board an email entitled "Offer to Take Tesla Private at \$420." Musk did not discuss the \$420 price with any funding source prior to sending the email. Musk later said there was "a lot of uncertainty" regarding the possible transaction. In an August 3rd phone call with the board, Musk expressed his hope that many shareholders would stay with the company even if the company went private. He asked for the board's authorization to contact shareholders to sound out their interest in the proposed deal.

The complaint alleges that between July 31, 2018 and August 7, 2018, Musk did not discuss a take-private transaction at \$420 per share with any other funding source, did not provide Tesla's board with a more specific proposal to take Tesla private, did not retain any advisors, did not contact any retail investors or determine whether institutional investors had restrictions on holding what would be illiquid shares if Tesla were to go private, and did not determine what regulatory approvals would be required for a take private transaction.

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Notwithstanding all of these limitations, Musk nevertheless launched his tweets during the day on August 7th. The SEC's complaint alleges that following the first of Musk's tweets, Tesla's share price rose over 6% and it closed the day up over 10%. The complaint shows that Musk's tweets clearly caught not only investors and analysts by surprise, but caught company officials by surprise as well.

On August 24th, after the close of trading, Tesla published a blog post stating that Musk had abandoned the process of trying to take Tesla private.

## **THE SEC'S COMPLAINT AGAINST MUSK**

In alleging that Musk's Twitter statements on August 7th had been false and misleading, the SEC stated that "Musk's statements that funding was 'secured' and investor support was 'confirmed' were false and misleading because, in reality, Musk had not 'secured' or 'confirmed' commitment from any source to provide any amount of funding." In addition, he had never even discussed taking Tesla private at a price of \$420 per share with the Fund or any other potential investor. The SEC alleged that Musk's statement that the only remaining contingency was a shareholder vote was also false and misleading because no formal proposal had ever been presented to the board. The SEC also alleged that there were numerous omissions from his disclosures of facts that were known to him, including the relative limitation of his discussions with the sovereign wealth fund and with the board.

The complaint alleged that by engaging in this conduct, "Musk violated, and unless restrained and enjoined, will violate again" Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder. The complaint sought injunctive relief, disgorgement, civil penalties, and a bar prohibiting Musk from serving as an officer or director of any public company.

## **THE SETTLEMENT**

As detailed in a September 29th press release, the SEC, Musk, and Tesla each a settlement of the enforcement action. According to the press release, Musk agreed to pay the agency

\$20 million and step down as the company's Chairman. The agency's action against Tesla was also resolved as part of the SEC's settlement with Musk. In its complaint against Tesla, the agency alleged that Tesla had failed to institute required disclosure controls and procedures relating to Musk's tweets, a charge that Tesla agreed to settle. As part of the settlement, the company also agreed to pay a \$20 million penalty, adopt certain governance reforms, appoint an independent Chairman, and appoint two independent directors. The \$40 million in penalties is to be distributed to harmed investors as part of a court-supervised process. The settlement is subject to court approval.

## **DISCUSSION**

This is the first SEC enforcement action based on alleged misrepresentations or omission in statements on Twitter. Further, John Reed Stark, President of John Reed Stark Consulting and former Chief of the SEC's Office of Internet Enforcement, states that a close reading of the SEC's complaint against the celebrated billionaire finds a litany of glaring absences within the SEC's allegations, including:

- No alleged profits or other ill-gotten gains earned by Musk;
- No alleged scheme conducted by Musk;
- No alleged market manipulation orchestrated by Musk;
- No alleged pump and dump ploy executed by Musk;
- No alleged conspiracy between Musk and anyone else;
- No alleged evidence of scienter or intent by Musk;
- No alleged false filing or other false or inaccurate Tesla report to the SEC by Musk;
- No alleged violation of any sort of required SEC "quiet period" by Musk.

Of importance, the SEC makes a point in its press release that the securities laws apply even to statements made within the relatively informal and less structured world of social media. The press release quotes Stephanie Avakian, Co-Director of the SEC's Enforcement Division, as saying that the obligation to provide investors with truthful information "applies

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with equal force when the communications are made via social media or another non-traditional form.”

The circumstances of this case underscore the dangers to public companies when company executives use social media for communicating with investors. The media's informality and unstructured environment create their own perils, but those dangers are magnified if an executive uses the media impulsively and without the kind of oversight, review, and scrutiny that would be employed in communications about corporate transactions using more traditional means. The SEC's complaint highlights the dangers involved under these kinds of circumstances: “Musk made his false and misleading public statements about taking Tesla private using his mobile phone in the middle of the active trading day. He did not discuss the content of the statements with anyone else prior to publishing them to his over 22 million Twitter followers and anyone else with access to the Internet. He also did not inform Nasdaq that he intended to make this public announcement, as Nasdaq rules required.”

The SEC's complaint makes it clear that corporate executives who mislead investors, as Musk is alleged to have done, are not going to

be let off the hook or given any leeway merely because the medium used to communicate is one of relative informality, like Twitter. Musk's statements clearly had a significant market impact, without respect to the fact that the statements appeared only on social media.

Of all the many interesting things about the SEC's complaint, perhaps the most interesting is the SEC's initial request for an officer and director bar against Musk. Ultimately, the SEC did not insist on an officer and director bar as part of its settlement; Musk agreed only to step down as the company's Chairman, while being permitted to continue as the company's CEO. Notwithstanding the compromise, the SEC's message seems clear, that it intends to pursue claims against corporate officials for alleged misrepresentations, and its pursuit will include even the most far-reaching remedies.

The final message is that the SEC intends to pursue claims for any statements which allegedly mislead investors, regardless of who made the statements and regardless of the medium used to make the statement.

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