

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—D.

Del.: Tesla directors sued for failing to control CEO's tweets, (Feb. 13, 2019)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By Rebecca Kahn, J.D.

Shareholder's putative class action targets Tesla directors for Elon Musk's "go-private" tweets.

A Tesla shareholder has brought a derivative suit against the electric car maker's directors, including CEO Elon Musk, alleging failure to control Musk's tweets about taking Tesla private to his 22 million followers and resulting damage to Tesla. The directors allegedly engaged in fraud and unjust enrichment, breached fiduciary duties, wasted corporate assets, and violated proxy statement requirements. Specifically, they failed to disclose that Tesla lacked internal controls and procedures to ensure that Musk's tweets were accurate, truthful, and otherwise complied with all laws and regulations ([Klein v. Musk](#), February 11, 2019).

Tesla, Inc., a publicly traded company, is a leading designer, manufacturer, and distributor of specialty vehicles. Tesla's co-founder and figurehead, Elon Musk, has served as Tesla's CEO since October 2008 and chaired its board of directors since April 2004. Musk also co-founded SpaceX and chaired the board of SolarCity from July 2006 until its acquisition by Tesla in November 2016.

Twitter use. Musk's Twitter account is one form of communication used to share Tesla news. In its November 5, 2013 Form 8-K, Tesla expressly stated that it would disseminate information "through a variety of means," including its website, press releases, SEC filings, blogs, and social media.

Saudi interest. Beginning in January 2017, Musk had numerous in-person meetings with representatives of a sovereign Saudi Arabian investment fund (the "Fund"), which expressed a desire to establish a Tesla production facility in the Middle East. Fund representatives met with Musk repeatedly in July 2018, informing him that the Fund had recently acquired nearly 5 percent of Tesla's common stock on the open market, and was interested in taking Tesla private. These meetings allegedly "lacked discussion of even the most fundamental terms of a proposed going-private transaction." Nothing was exchanged in writing, and there was no discussion of confidentiality, the complaint alleged.

Board knowledge. On August 2, 2018, Musk emailed Tesla's board, CFO, and general counsel with the subject, "Offer to Take Tesla Private at \$420." He explained that being public "[s]ubjects Tesla to constant defamatory attacks by the short-selling community, resulting in great harm to our valuable brand." In the email, Musk asked that the "matter be put to a shareholder vote at the earliest opportunity" and stated that the "offer expires in 30 days." At a phone conference on August 3, Musk informed the board that the Fund was interested in funding a going-private transaction, but at least one board member told him that it would be difficult for small investors to remain shareholders in a private Tesla. As such, the board authorized Musk to contact certain investors and report back to the board on those conversations.

August 7 tweets. In a series of tweets on August 7, 2018, Musk stated that he could take Tesla private and that funding was secured with the only outstanding contingency being a shareholder vote. There was considerable share price fluctuation as a result of this tweet and subsequent media reports.

SEC settlement. The SEC brought an enforcement action against both Tesla and Musk on September 29, 2018, based on Musk's August 7th series of tweets. The action was quickly settled for \$40 million and Musk relinquished his chairman position for three years, but remained a director. The settlement orders Tesla to implement governance changes to better manage Musk's public communications. The Musk settlement also permanently restrained and enjoined Musk from violating Exchange Act Section 10(b). Musk posted a tweet on

October 4, 2018: "Just want to [sic] that the Short seller Enrichment Commission is doing incredible work. And the name change is so on point[.]" Many news organizations reported on this tweet, including a Reuters article entitled "Tesla's Musk mocks SEC as judge demands they justify fraud settlement". Nevertheless, a Manhattan federal judge [approved](#) the settlement on October 16, 2018.

Derivative suit. The current action alleges Tesla's failure to control Musk's August 7, 2018 going-private disclosures or to implement procedures to assess whether such information should have first been disclosed in SEC reports. Musk allegedly 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 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. Musk's statements were "premised on a long series of baseless assumptions and were contrary to facts" that Musk knew. Musk knew that Tesla's board had not yet voted on any go-private proposal or authorized a shareholder vote on it and, in fact, Musk had not yet even submitted a formal proposal to Tesla's board.

This action was filed against certain of its officers and directors claiming that, because the board lacked internal controls, it failed to review or oversee Musk's tweets to the investing public, resulting in artificially inflated Tesla share price. The misconduct of Tesla and its officers and directors allegedly negatively impacted its stock price and goodwill and has subjected it to various litigation. The complaint alleges that the director defendants knew, should have known, and/or were reckless in disregarding Musk's history of making false and/or misleading statements.

The complaint alleges that director defendants violated Exchange Act Section 10(b) and Rule 10b-5 thereunder for disseminating, permitting, or approving public statements that failed to disclose (a) that Musk's August 7, 2018 tweets regarding taking Tesla private were not truthful or accurate; (b) that funding was secured for this "going private" transaction was not truthful or accurate; (c) that lacked internal controls and procedures to ensure that Musk's communications with the investing public were accurate, truthful, and otherwise complied with all laws and regulations; and (d) that as a result, the price of the company's shares was artificially inflated due to the deception of the director defendants. Tesla's shareholder alleges company damages resulting from breaches of fiduciary duties, unjust enrichment, abuse of control, and waste of corporate assets. The action seeks improved corporate governance, risk management, and internal operating procedures to protect the company and its stockholders from a repeat of such "rampant wrongful conduct".

Since November 2013, Musk has used his Twitter account to publish material information about Tesla to more than 22 million followers, including members of the press. Musk did not routinely consult with anyone at Tesla before publishing Tesla-related information via his Twitter account. Likewise, no one at Tesla reviewed Musk's tweets prior to publication. Since Tesla's November 5, 2013 Form 8-K (disclosing that Musk's Twitter account would be used to disseminate material information about the company) Tesla did not have disclosure controls or procedures in place to assess whether Musk's tweets were required to be disclosed in Tesla's Exchange Act reports per SEC rules and forms. Nor did Tesla have sufficient processes in place to ensure the information Musk published via his Twitter account was accurate or complete. Indeed, until after the August 7, 2018 tweets, Tesla had no corporate policies that specifically addressed Musk's use of Twitter.

Demand futility. The complaint alleges demand futility due to all board members' incapability of making an independent and disinterested decision to pursue this action due to, among other things, "outsized" compensation, overlapping interests with other Musk companies, breaches of fiduciary duty, and loyalty to Musk. It alleges that the director defendants either knew or should have known of the false and misleading statements that were issued on the company's behalf and took no steps in a good faith effort to prevent or remedy that situation, proximately causing millions of dollars of losses for Tesla shareholders.

The case is [No. 1:19-cv-00298-CFC](#).

Attorneys: Ryan M. Ernst (O'Kelly Ernst & Joyce, LLC) for Melvyn Klein.

LitigationEnforcement: CorporateGovernance CorpGovNews GCNNews DirectorsOfficers FormsFilings
FraudManipulation PublicCompanyReportingDisclosure DelawareNews