Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—D. Ariz.: EV maker dodges shareholder fraud suit, (Feb. 3, 2023)

Securities Regulation Daily Wrap Up

By Mark S. Nelson, J.D.

The court found some statements to be actionable and that scienter existed against the company and its former CEO, but that the case ultimately turned on the insufficiently pleaded element of loss causation.

Electric vehicle company Nikola Corporation won the dismissal of a civil securities fraud suit brought against the company and numerous company executives, including the company's ex-CEO. The complaint asserted both maker and scheme liability predicated on allegedly misleading statements about the viability of Nikola's electric vehicles and a related hydrogen fueling infrastructure. Although the court found the claims brought against Nikola's ex-CEO could be actionable, the court ultimately dismissed the case because the complaint failed to plead loss causation. Likewise, because there was no surviving primarily securities violation, the court dismissed related controlling person claims. The plaintiff has until April 3, 2023, to further amend the complaint (*Borteanu v. Nikola Corporation*, February 1, 2023, Logan, S.).

Misrepresentations. The court began it analysis by finding that pre-class statements would not be dismissed under Ninth Circuit precedent (or more accurately lack of precedent) because finding otherwise would permit the company and the individual defendants to exploit a logical loophole. Still, the question of whether the pre-class period statements could be actionable would have to await a later stage of the litigation.

The court then addressed 22 statements allegedly made by the defendants in Nikola's SEC filings. The court separated them into five categories:

- **Backlogged or pre-ordered vehicles—**The complaint alleged that statements about these orders were misleading because the orders were not true orders since they were cancellable anytime, while the defendants asserted that the statements were accompanied by cautionary language. The court concluded that the cautionary language was insufficient to render the statements non-actionable.

- **Nikola's business model—** According to the complaint, certain of Nikola's trucks and its hydrogen fueling capabilities were not "core product offering[s]" but rather were as-yet unrealized "concepts." However, the court concluded that the combination of cautionary language from the company and the fact that the trucks at issue and the related hydrogen infrastructure were "central" to Nikola's business model rendered the statements non-actionable.

- **Nikola's hydrogen capabilities—** The complaint alleged that Nikola lacked the ability to make and dispense hydrogen. The court found one Nikola statement was non-actionable because it did not assert that hydrogen production equipment had been purchased, that power supplies had been obtained, that the equipment could be used at a particular station, or that it was producing hydrogen. The complaint also claimed that Nikola misrepresented the capabilities of its "demo" stations. With respect to these latter allegations, the court concluded that Nikola had carefully parsed its assertions about its capabilities and/or surrounded those statements with cautionary language that rendered them non-actionable.

- **Hybrid pickup truck—**The complaint alleged that Nikola failed to disclose that its hybrid truck was just a "computer rendering of a non-existent truck." For its part, Nikola said its disclosures emphasized other projects and that the hybrid truck would only go forward if a strategic partnership were to develop. The court, however,

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concluded that other disclosures and the ex-CEO's statements implied that the hybrid truck was at least a "prototype" and in any event was more than a mere computer rendering. Thus, these statements could be actionable.

- **Semitruck—**The complaint asserted that Nikola had abandoned its semitruck project but still told investors it was one of its "Zero-Emission Product Offerings." Nikola's statements, said the court, could be actionable. The complaint further asserted that the semitruck was not a "real truck" but was instead a "pusher" that could not move under its own power. The court concluded that Nikola's related statement was not misleading because it had disclosed that the semitruck could not move under its own power. Moreover, the court concluded that Nikola's statements about a video showing the semitruck rolling down a hill had been carefully parsed (despite some language that implied the semitruck moved on its own) to disclose that the semitruck was unable to move under its own power and, thus, were not actionable.

Because one of the statements found not to be actionable involved defendant Brian M. Whorthen, the case against him was dismissed.

Lastly, numerous statements made by Nikola's ex-CEO were found to be actionable. Here, the court rejected attempts by the ex-CEO to characterize his statements as non-actionable based on the context in which they were made. The court also rejected arguments that the statements were merely opinion, puffery, or statements of optimism. The ex-CEO had frequently stated that the company would not build vehicles based on speculation but only upon orders; the ex-CEO even likened Nikola's order intake to that of the world's two largest aircraft manufacturers.

Scheme liability. In analyzing the complaint's alleged scheme under Exchange Act Rules 10b-5(a) and 10b-5(c), the court focused on the first element regarding whether the six individual defendants engaged in conduct amounting to a manipulative device or contrivance. The complaint had focused on several items, including that the defendant's falsely boosted Nikola's ex-CEO's trustworthiness, approved a misleading press release, created a system to reward themselves for fraud, and denied key elements of a third-party report on Nikola.

The court generally found that the complaint failed to allege sufficient facts to allege the purpose and effect of the individual defendants' conduct. The court also emphasized that the complaint's allegations were insufficiently particular. For example, the allegation that the individual defendants falsely boosted the company's ex-CEO's credibility were conclusory. The court also noted the some of the individual defendants had opposed the ex-CEO's statements. As a result, the complaint failed to allege that the individual defendants engaged in deceptive acts in furtherance of the alleged scheme. However, the scheme liability claim against the company's ex-CEO was found to be sufficiently alleged.

Scienter. The court's analysis of scienter was limited to the maker liability claim under Exchange Act Section 10b-5(b) because the scheme liability claim had been dismissed (except with respect to Nikola's ex-CEO). The complaint alleged that the individual defendants could be found to have acted with scienter under multiple theories, including that their signatures appeared on SEC filings, motive and opportunity, and the core operations theory.

The court, however, examined each of these theories and found them lacking. The court's reasoning appeared to focus on the fact that while some of the individual defendants' statements were found to be misleading, they nevertheless did not demonstrate a deliberate recklessness sufficient to arise to scienter. Said the court: "The Court finds it far more likely, based on the facts alleged by Plaintiff, that the Individual Defendants were simply careless in failing to disclose the relevant facts more comprehensively."

But with respect to the Company's ex-CEO, the court concluded that scienter had been alleged. The ex-CEO, noted

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the court, was aware that others believed he was making misleading statements and he used his position as CEO to exercise “unfettered control” over the company. As a result, the complaint alleged scienter against the ex-CEO. Moreover, the ex-CEO’s scienter was imputed to Nikola, a conclusion that the other individual defendants did not dispute.

Loss causation. Once again, the court limited its analysis of an element of the plaintiffs’ case to a discussion of Nikola’s ex-CEO because the claims against the other individual defendants had already been dismissed. Loss causation requires a showing of a causal connection between a defendant’s allegedly deceptive act and the plaintiff’s loss.

Here, the court noted that the complaint asserted 11 corrective disclosures that could reveal the truth about the ex-CEO’s allegedly deceptive acts. These disclosures involved a range of events and announcements, including a short seller report, various media reports, reports about the ex-CEO’s resignation, and reports about civil and criminal charges brought against the ex-CEO.

According to the court, however, the complaint failed to plead loss causation with sufficient particularity. The court observed that the complaint failed to identify the specific misstatements and omissions that were allegedly revealed by each corrective disclosure.

The case is No. 2:20-cv-01797.

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