Securities Regulation Daily Wrap Up, MERGERS AND ACQUISITIONS—Del. Ch.: Twitter sues Elon Musk to enforce Musk's bid to acquire the social media platform, (Jul. 13, 2022)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

Twitter's breach of contract case may be a prelude to follow-on suits by investors for securities fraud and fiduciary duty claims depending on whether the merger closes.

Twitter, Inc. responded to Elon Musk's announcement that he was terminating his bid to acquire the social media platform by filing a breach of contract suit in Delaware state court. The complaint seeks to rebut claims by Musk that Twitter refused to provide details on spam accounts and that the company recently sought to trash its business in violation of the merger agreement by firing several key executives and conducting sizeable layoffs. Twitter's lawsuit asks the Chancery Court to award specific performance of the merger agreement, in essence, requiring Musk to close the deal (*Twitter, Inc. v. Musk*, July 12, 2022).

A "seller friendly" road to Delaware. The Musk-Twitter acquisition began perhaps inauspiciously when Musk allegedly was late in filing documents with the SEC related to his acquisition of a controlling block of Twitter shares. From there, market conditions shifted with investors placing greater emphasis on inflationary conditions in the general economy and the financial dynamics of the Musk-Twitter deal evolving for their own unique reasons to possibly suggest that Musk had overpaid for a company that apparently has few, if any, other suitors (for comparison, observe the roughly contemporaneous and far more competitive, although unresolved, bidding dynamics regarding efforts by JetBlue Airways and Frontier Airlines to acquire Spirit Airlines). Then, Musk began asking Twitter to divulge information about the degree to which unauthorized bots operate on Twitter's platform while media speculation began to swirl about whether Musk was ever serious about acquiring Twitter. All of the above were stepping-stones on the path to America's corporate court, the Delaware Court of Chancery.

On Friday July 8, 2022, Musk filed a Schedule 13D with the SEC in which he linked to a letter sent to Twitter explaining why he was backing out of the merger agreement. According to the letter drafted by Musk's outside counsel, Twitter had breached the agreement multiple times, made false and misleading statement in its filings with the SEC (primarily about the "prevalence of fake or spam accounts" on its platform), and alleging that Twitter's breaches may trigger the material adverse effect provision of the merger agreement. Musk also said Twitter failed to preserve its business during the merger process by firing two key executives, laying off a sizeable proportion of its talent acquisition staff, and implementing a hiring freeze. Twitter responded via a Form 8-K in which it denied Musk's allegations and reiterated its desire to complete the merger, even if that means filing suit in the Delaware state courts to enforce the merger agreement.

Twitter's complaint alleges that Musk and Twitter entered into a binding merger agreement for $54.20 per share or $44 billion in which Musk was to use his best efforts to close the deal. The agreement was, in Twitter's words, "seller friendly" in that it did not contain strong language about financing contingencies or diligence conditions, and it asserted that financing commitments had been obtained (the complaint said the financing commitment was subject to a "hell-or-high-water" obligation to close). Specifically, Musk was to pay a 38 percent premium above Twitter's unaffected share price and Musk himself committed to pay $33.5 billion of the merger price.

Twitter further alleged that, contrary to the anti-disparagement provision of the merger agreement, Musk has repeatedly disparaged the company. The complaint noted that Musk's Twitter footprint has existed since 2009 and includes 100 million followers and a total of more than 18,000 posts by Musk, thus giving Musk a large online audience. With respect to Musk's accusation that Twitter improperly fired key executives, Twitter pointed to terms in the merger agreement that allow the company to retain authority to make personnel changes without Musk's consent.

Musk is no stranger to Delaware courts. In recent years Musk was found to be a controller at the pleading stage of a shareholder case against Tesla, Inc. regarding its acquisition of SolarCity Corporation that ultimately resulted in something like a summary judgment tie, although nominally a narrow win for Musk and Tesla regarding a sliver of the case, but without deciding the issue of whether Musk was a conflicted controller. The court later determined that despite many potential conflicts and other problems with the deal, Tesla's acquisition of SolarCity Corporation was entirely fair.

In another case, Musk's controller status was a key factor in a pleading stage win for shareholders challenging Musk's Tesla pay package, although the court went on to imply that even though the *MFW* deal review opinion (i.e., business judgement rule applies if deal protections are timely imposed) applies only to squeeze-out mergers, the *MFW* deal protections could function as "potent neutralizers in other applications," such as the dispute over Musk's Tesla compensation, had Tesla put such protections in place. Musk also has been sued in Delaware, and elsewhere, regarding his alleged failures to get his Tweets preapproved under a prior SEC settlement.

Specific performance. Twitter's complaint seeks specific performance of the merger agreement by Musk plus other injunctive relief to compel Musk to satisfy any remaining conditions necessary to consummate the acquisition. Remaining conditions include a Twitter shareholder vote, regulatory approvals, and the non-occurrence of any company material adverse effect (MAE). According to Twitter, the seller-friendly character of the merger agreement means that many typical MAEs were excluded from the deal, including changed circumstances that have a general effect on markets or the social media industry. Moreover, the complaint asserts that Musk's breach of the merger agreement precludes his invocation of the termination provision.

In Delaware, specific performance is available as a remedy if: (1) there is a valid contract; (2) the party seeking specific performance is ready, willing, and able to perform; and (3) the balance of equities favors the party seeking specific performance. The party seeking specific performance must establish its entitlement to the remedy by clear and convincing evidence. These requirements were stated by former Chancellor Andre G. Bouchard in a case in which Channel MedSystems, Inc. obtained specific performance of a merger agreement against Boston Scientific Corporation in which the court concluded that the presence of some inaccurate representations did not establish that such inaccuracies would reasonably be expected to have a material adverse effect.

Still other recent Delaware Chancery cases trend in favor of awarding specific performance in the merger/asset purchase context (See e.g., *Level 4 Yoga, LLC v. CorePower Yoga, LLC* (Del. Ch. March 1, 2022) (the court's final order and judgment were subsequently stayed pending appeal); *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.* (Del. Ch. July 9, 2021); *Snow Phipps Group, LLC v. KCake Acquistion, Inc.* (Del. Ch. April 30, 2021); *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.* (Del. Ch. October 25, 2013).

With respect to Musk, his claim to a right to terminate must appear in the merger agreement under DGCL Section 251(d). Under this provision, a merger contract allowing for termination must state that termination may be achieved by one or both boards of directors notwithstanding a contrary shareholder vote by one or both companies' shareholders. A certificate of termination may have to be filed depending on when the termination occurs (See also, Balotti and Finkelstein, Delaware Law of Corporations and Business Organizations, Section 9.15 (abandonment or termination) (The Balotti and Finkelstein treatise is a publication of Wolters Kluwer Legal & Regulatory U.S.).

The case is No. 2022-0613.

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Companies: Twitter, Inc.; X Holdings I, Inc.; X Holdings II, Inc.

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