'In re Tesla,' Tweets, And Securities Fraud

By **Anthony Michael Sabino**

In the brave, new world of social media, corporate leaders increasingly disseminate pertinent information to stakeholders via tweets and blogs. Judiciously employed, social media has obvious benefits; yet, used imprudently, tweets and the like can easily ensnare businesses in costly lawsuits. The truth of the latter point was recently proven by *In re Tesla, Inc. Securities Litigation*, ___ F.Supp.3d ___ (No. 18-cv-04865) (N. D. Cal. April 15, 2020), where shareholders alleged a variety of federal securities code violations stemming from a controversial outburst of tweets from the automaker's CEO. Given that any publicly held corporation is susceptible to litigation of this sort any time its executives go on social media, this decision is worthy of our attention.

Social Media and the CEO

A bit of history aids our analysis. Elon Musk, Tesla's co-founder, current CEO, and former chair, has long had an acrimonious relationship with the "short sellers," investors who have essentially gambled that the company's share price shall decline. Those shorting the stock have, at various times, controlled as much as one-quarter of the corporation's outstanding shares, and Musk's hostility toward these pessimists is well documented.

That might explain the crux of the instant litigation: three social media communications by Musk, issued in staccato fashion, proclaiming that he was taking Tesla private, and thereby ousting the company's detractors, once and for all. The first was a personal tweet, dated August 7, 2018, wherein the CEO tersely announced he had "funding secured" to buy out shareholders at $420 per share (a 20% premium over the market price at that time). This was followed on Aug. 13 by another individual tweet, in which the former chair claimed that he had retained well known investment banks and law firms to advise him.

That same day, the company's co-founder added a blog post assuring his vast audience there was "no question" that a Saudi Arabian sovereign wealth fund would provide the financing necessary for going private. As is well known, the proposed buyout quickly disintegrated, and the corporation to this day remains publicly held.

One last, pertinent fact: in late September, 2018, the Securities and Exchange Commission charged Musk and Tesla with disseminating misleading statements. Remarkably, less than three weeks later, the CEO and the company settled with the SEC by agreeing to pay penalties of $20 million each.

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A shareholder complaint alleging that Musk and Tesla had violated the anti-fraud provisions of the 1934 Securities Exchange Act, 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5, soon followed. When the defendants moved to dismiss that pleading, the matter came before Judge Edward M. Chen of the Northern District of California for adjudication.

Tweets as Material Misrepresentations

As recently exposited in this space, *see* Sabino, "*#MeToo* and Securities Fraud: Lessons from the *CBS* Case," 263 *New York Law Journal* p.4, cl. 4 (June 3, 2020), pleading securities fraud is a formidable task. A granitic arc of Supreme Court landmarks demands that a complaint set forth with specificity claims of: 1) material misrepresentations or omissions; 2) made with scienter; 3) in connection with the purchase or sale of a security; 4) reliance upon same by the plaintiff; 5) economic loss; and 6) loss causation. *See Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013).

In accordance with this mandate, the *Tesla* court had to first determine if Musk's tweets and blog post qualified as material misrepresentations. Interestingly, the defendants staunchly denied that these communications could ever be construed as such, asserting that, to the contrary, the CEO's social media advisories were purely aspirational, and, moreover, conditional.

The district court begged to differ. Judge Chen found that it was beyond question that Musk's declarations were unconditional, and phrased in the past tense. Tesla's co-founder had expressed certitude as to his funding, and specified the share price to take the automaker private. A reasonable investor could interpret these assertions as representations of fact, not "speculative amorphous opinion." Lastly, the trial court reminded that the Supreme Court recently ruled that opinions predicated upon facts (as Musk's tweets and blog post supposedly were) can be transmogrified into actionable, material misrepresentations. *See Omnicare, Inc. v. Laborers District Council Construction Industrial Pension Fund*, 575 U.S. 175 (2015) (Kagan, J.).

Social Media as Evidence of Scienter

The bench's next task was to determine if scienter was pled sufficiently. Venerable high Court precedent informs that scienter is a mental state embracing an intention to deceive. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). And, given that pleading a state of mind is problematic at best, both statute and case law are » Page 8

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permissive of alleging scienter by a strong inference, which at least matches plausible explanations for the purported wrongdoing. *See* 15 U.S.C. § 78u-4(b)(2). *See also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

The defendants stayed their course, once more contending that Musk's notifications were no more than aspirational. The court was once again unpersuaded. Judge Chen decreed that the plaintiff had made credible allegations that the CEO knew or should have known financing was by no means assured, he had not yet formally retained able bankers and attorneys, and there were significant impediments to taking Tesla private.

In addition, the district court adroitly factored in the corporate head's historical combativeness with Tesla's short sellers, and the SEC settlement. The trial bench made it abundantly clear that neither point could, by itself, constitute a satisfactory demonstration of scienter.

Nevertheless, the CEO's animus towards the shorts tended to provide a motive for his actions, and therefore qualified as circumstantial evidence of evil intent. Judge Chen went so far as to archly posit that even if Musk had nothing to gain financially by misstating the certainty of a buyout, Tesla's cofounder "stood to gain satisfaction from watching the short-sellers lose on their investments."

Likewise, the swift closure of the SEC litigation, while again not dispositive in isolation, lent ancillary support to the scienter allegations. Judge Chen gave credence to the remarkable 'temporal proximity" between the commencement of the enforcement action and its resolution only weeks later.

We pause here to comment parenthetically that the trial bench bypassed the third and fourth components of the securities fraud pleading rubric: in connection with the purchase or sale of a security, and reliance, respectively. It can only be assumed that the former was never in dispute, and the latter was left for another day.

Linking Tweets to Loss and Loss Causation

The *Tesla* court now proceeded to combine its analysis of the fifth element of securities fraud with the sixth pleading requirement, respectively, economic loss and loss causation. In relation to the former, Judge Chen examined the allegation that Tesla's shareholders were generally enthralled at the prospect of either remaining onboard as part of a select ownership group or being bought out at a hefty premium. With nearly a half dozen decreases in Tesla's price per share in less than ten days, all linked to the social media flareup, economic loss ceased to be a question.

Turning to review the allegations of loss causation, the district court took the noteworthy step of bifurcating the Tesla shareowners into short sellers and long term stockholders. Notwithstanding the novel distinction, this analysis would still be guided by *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), wherein the Supreme Court decreed that a plaintiff is obligated to link the allegedly deceitful acts to his actual market losses.

Judge Chen was well satisfied with the plaintiff's allegations that Musk's repeated communiqués giving assurance of committed funding and a buyout at $420 had artificially inflated the automaker's stock valuation, forcing the shorts to "cover" their positions at substantial expense. Given the previous cataloguing of the declines in Tesla's shares which occurred in the wake of subsequent corrective revelations, the trial court ascertained that a causal link had been adequately shown. And that causality was equally applicable to long-term investors, who had likewise suffered from the gyrations in the company's price per share.

The district court's final ruling was almost an afterthought. The plaintiff had asserted a claim for control person liability, that proviso of the 1934 Act which imposes liability upon those that control a primary violator of the securities laws. *See* 15 U.S.C. § 78t. With only the barest of mentions, Judge Chen ruled that the plaintiff had adequately pled the corporation's control over its loquacious CEO and his access to social media. For all these reasons, the motion to dismiss was denied, and the lawsuit was allowed to continue.

Preventing Social Media From Fomenting Securities Litigation

The conclusions to be drawn from *Tesla* are fairly obvious, but still worthy of exposition. Corporate leaders must be sternly forewarned that anything they tweet or blog could foment securities fraud litigation. Accordingly, robust protocols and oversight as to social media must be in place, and applied without exception. Proactive measures can prevent litigation or at least aid in mounting a defense. And speaking of defending, the defendants in the instant case were handicapped by the CEO's well known friction with a key shareholder constituency. In leading a publicly held corporation, the value of discretion in avoiding or prevailing in litigation should never be underestimated, as *Tesla* aptly demonstrates.

In closing, *Tesla* is highly instructive regarding the requirements for pleading securities fraud, especially where the central allegations are that company tweets and blogs misled investors. Yet its greatest lesson is far more elementary. Social media is like fire: beneficial when employed wisely, capable of great harm if wielded recklessly. Success or failure in advising corporate leaders or litigating their defense hinges upon that undeniable truth.