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Twitter v. Musk: The "Trial of the Century" That Wasn't

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FEATURE

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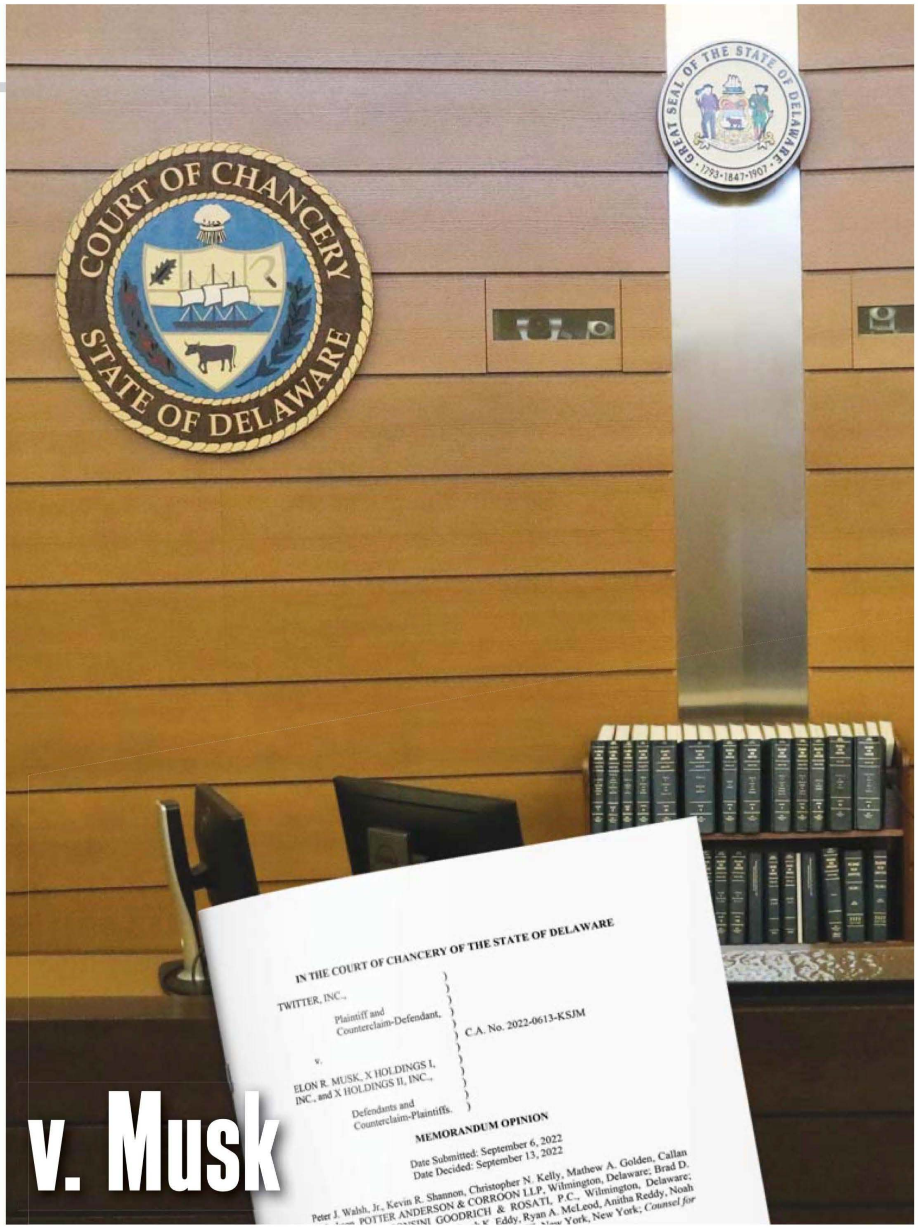

Twitter v. Musk

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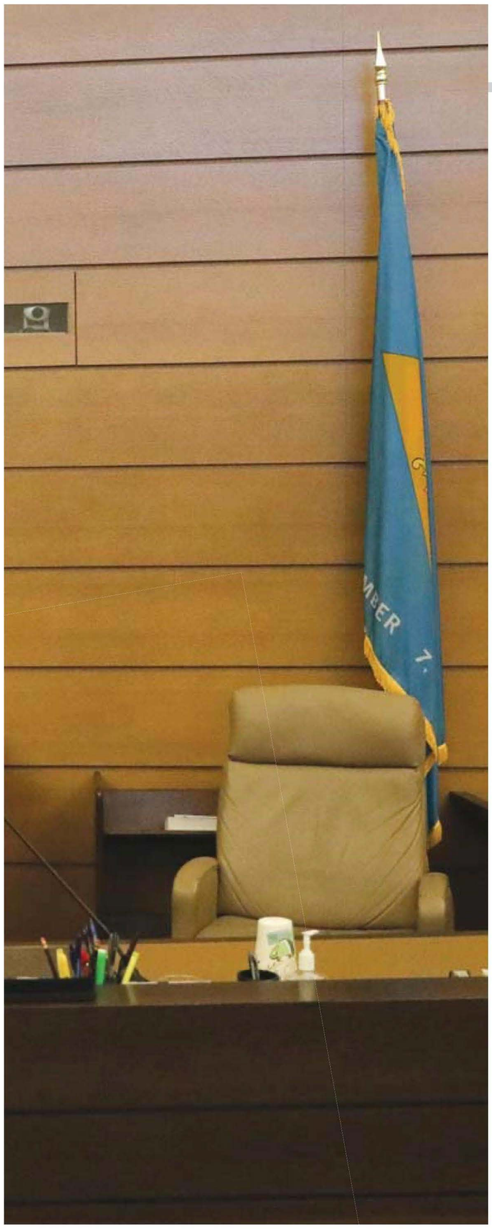
Introduction

The months-long saga over Elon Musk's on-again, off-again acquisition of Twitter provided considerable entertainment for lawyers and laypeople alike. But for those of us who teach business law, it also provided a unique (and in certain ways, vexing) opportunity to show real-time examples of the legal principles that are the grist for courses in contracts, corporations, corporate finance, and mergers and acquisitions.

Both of us found ourselves incorporating the saga into our classroom discussions, which in turn informed our own thinking about how the dynamic played out. Although we were both relatively active on social media (indeed on Twitter itself) as the saga unfolded, the final closing of the deal in late October has given us a chance to reflect on our own takeaways in hindsight.



Merits of the Claims/Defenses

By now, most readers are familiar with the story. On April 4, 2022, Elon Musk revealed he had acquired a 9.1% stake in Twitter.[1] After agreeing, and then not agreeing, to join Twitter's board, Musk made an unsolicited offer to buy all of Twitter's stock at $54.20 per share. (420 is a weed joke.[2]) While above Twitter's then-current trading price, the offer seemed at the time to be disturbingly low, as Twitter had been trading in the $60-70 range only a year earlier. Doubts about Musk's level of commitment were partially allayed, however, when he lined up a consortium of banks to fund about $13 billion of the total $44 billion purchase price,[3] secured by Twitter's cash flows, with Musk and any potential co-investors making up the difference. After initially responding with a poison pill (which itself echoed a 420 meme), Twitter's board rapidly agreed to the deal on Musk's offered terms, and, over a weekend, signed onto a merger agreement.

The merger agreement itself bore a strong family resemblance to other private equity deals, but it contained several features that would loom large as the kerfuffle unfolded. First, Musk disclaimed reliance on any statements other than the representations and warranties contained in the merger agreement itself, and those reps and warranties guaranteed the accuracy of only those Securities and Exchange Commission (SEC) reports that had been filed after January 1, 2022. That's a break from more standard practices, which typically pull in filings going back some years. Moreover, closing was only conditioned on these SEC representations not being so false that they would qualify as a "material adverse effect" (MAE). In turn, the MAE definition was itself *mostly* standard, though it contained a very *non-standard* carve-out that excluded idiosyncrasies that might emerge "by reason of the identity of Elon Musk."[4] Second, the parties stipulated that damages would be inadequate to remedy a breach by either party, and therefore a specific performance injunction would be appropriate; the parties even went so far as to agree they would *not even attempt to argue* in court that specific performance was unwarranted. Third, the specific performance provision itself contained its own conspicuous carve-out, under which injunctive relief would be unavailable if (*inter alia*) Musk's lenders did not pony up their required contributions to the purchase price. And, in the event damages were awarded (rather than specific performance) as a remedy for breach, the amount appeared to be capped at $1 billion for either side. Fourth, closing was conditioned on the usual regulatory approvals and the absence of an MAE. Finally, and unremarkably (though critically), the agreement provided that it would be governed by Delaware law, and all disputes would be litigated in a Delaware forum.

Almost immediately after the acquisition was signed, tech stocks began a sector-wide swoon, and what had looked like a great deal for Musk in late April rapidly began losing its luster. The broad market retrenchment even hit shares of Tesla Inc., kneecapping Musk's personal (paper) wealth. And not coincidently, shortly after signing, Musk embarked on a perplexing path of indecision, first tweeting that the Twitter deal was "on hold" on May 13, but then subsequently claiming to be committed to going forward. At the same time, Musk's attorneys began trading increasingly dyspeptic — and public — letters with Twitter about the company's attempts to combat spam on the platform. Finally, on July 8, 2022, Musk purported to formally terminate the deal, with Twitter responding a few days later by filing suit in the Delaware Court of Chancery.

In his answer and counterclaims, Musk offered a variety of legal arguments for why he should be permitted to rescind or otherwise terminate the deal. But none seemed all that convincing based on public information; it soon became evident to most legal commenters (ourselves included) that this dispute — shorn of its celebrity trappings — appeared to be little more than a standard case of buyer's remorse, a conclusion that grew stronger with Musk's incessant proclivity to post tweets that often worked to undermine his most plausible legal arguments. Even the surprise appearance of a whistleblower – who surfaced once discovery was nearly completed – alleging a wide variety of new problems at Twitter, failed to move the needle.

Shaky as his defenses and counterclaims seemed to be on the surface, of course, discovery might reveal more. And in this spirit, Musk pursued three principal pathways for escaping the deal: contract claims, fraud claims, and — somewhat unexpectedly — claims under Texas's blue sky law. We address each in turn.

Contract Claims

As discussed above, Musk would be permitted to escape the deal if he could show Twitter had suffered an MAE whether due to misrepresentations in the agreement itself, or for other reasons. The key misrepresentations he seized upon, and that attracted most of the media attention, were Twitter's statements regarding its "monetizable daily active users," or mDAU, which translated to a rough estimate of the number of real humans — rather than bots or spam – regularly using the platform who could respond to advertisements. After the whistleblower's allegations that Twitter was violating the terms of a Federal Trade Commission settlement, had shaky claims to its intellectual property, and was vulnerable to sundry other data security flaws, Musk amended his counterclaims to include these allegations too, accusing Twitter of misrepresenting additional aspects of its business.

A key problem for Musk — and one that would continually haunt his contract claims — was that he made little to no attempt to connect any of these purported flaws to Delaware's standard for an MAE, namely, "an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period."[5] The contract would not allow an easy escape for inaccurate representations or other shortcomings of any less severity.

Musk additionally argued that Twitter breached its own covenant to supply information for any "reasonable business purpose related to the consummation" of the merger by denying him access to information about Twitter's spam detection and mDAU figures. While superficially an interesting claim, it soon became clear the information he sought seemed less related to *consummating* the deal than seeking a basis for *rescinding* it. Moreover, Twitter's information-sharing obligation expressly permitted it to withhold information if disclosure could "cause significant competitive harm" to the company — a risk that seemed more pressing as Musk began tweeting proposals to start a competing social media platform if the Twitter deal was not consummated.

Finally, Musk claimed that by freezing its hiring and conducting layoffs, Twitter breached its obligation to operate in the ordinary course of business between signing and closing. But that covenant only represented that Twitter use "commercially reasonable efforts to conduct the business … in the ordinary course," a phrase that Delaware has interpreted to mean in accordance with peer companies.[6] Because layoffs and hiring freezes were widespread in the tech sector at the time, this argument, too, seemed sketchy at best.

Common-Law Fraud Claims

As an alternative basis for rescinding the contract, Musk argued that he had been defrauded, and he focused on the same "misrepresentations" that formed the basis of his contract claims — namely, false user counts, misrepresentations regarding legal compliance, data privacy, security and similar matters. Musk faced obstacles here as well: for a fraud claim, Musk would not only need to prove *scienter* on the part of Twitter's management — for which he offered no evidence — but he would also need to establish that he *relied* on the purported misstatements. To outsiders, however, it seemed apparent that Musk had not relied on anything, diving into the deal on an apparent whim, repeatedly declaring (again via tweets) that one of his major contributions to Twitter would be to fix its "bot problem." Moreover, an important provision of the merger agreement specified that Twitter was not making any representations that were not expressly included in enumerated representations and warranties.[7] Finally, Twitter's own disclosure about its spam-fighting efforts seemed so heavily lawyered and caveated that it would be odd for any reasonable person to rely on them without also impounding an enormous margin for error.[8] To most outside observers, then, Mr. Musk's fraud claims seemed even more dicey than his contractual defenses.

Texas Securities Act Claims

States have "blue sky" laws that regulate the sale of securities within their territory. These are typically used to police local frauds perpetrated against retail investors, such as affinity frauds that target retirees. Like the federal Securities Act, many blue sky laws provide a rescission remedy when securities are sold on the basis of misstatements, even if the misstatements were negligent rather than intentional, and even if there has been no showing that the investor relied on them. Because these are mandatory laws, they cannot be evaded by contract: the law that controls is that of the jurisdiction with the materially greatest interest in the transaction, regardless of any agreements to the contrary.[9] Texas has its own blue sky law,[10] which is apparently why Musk invoked it in his battle with Twitter. If he could convince a court that Texas law applied by default, and had a materially greater interest in the dispute, it would trump the selection of Delaware law in the merger agreement, and he might have been able to rescind the contract based on false statements alone, notwithstanding the lack of a material adverse effect, a lack of reliance, and a lack of intent by Twitter.

This was the least developed argument before settlement. But had the case progressed in this direction, Twitter surely would have argued that there were no false statements on which to base a rescission remedy, and it may have argued that Texas's law should not cover merger transactions involving public companies. But the most significant (and we believe decisive) response would have been about Delaware itself. Delaware is famously protective of its status as the nation's producer and arbiter of corporate law. If Musk were able to sidestep a heavily negotiated merger agreement merely by invoking his presence in Texas during part of the negotiations,[11] it would severely undermine Delaware's dominance as a clear and predictable lodestar for merger agreement disputes (not

The Court of Chancery. (Seated left to right) Vice Chancellor Morgan T. Zurn, Vice Chancellor J. Travis Laster, Chancellor Kathaleen St. J. McCormick, Vice Chancellor Sam Glasscock III, Vice Chancellor Paul A. Fioravanti, Jr. (Standing) Master in Chancery Patricia W. Griffin (retired), Vice Chancellor Lori W. Will, Vice Chancellor Nathan A. Cook, Master in Chancery Selena E. Molina

to mention throwing pending and future merger agreements into chaos). It seems exceedingly unlikely that a Delaware court would ever find that *Texas* had the greater interest in this dispute in the first instance: Musk gave away that argument when he agreed to litigate any disputes in a Delaware forum.

It was therefore hard to see any of Musk's arguments being winners. To the contrary, Musk seemed overwhelmingly likely to be found to have knowingly and willfully breached the agreement himself. But that was only half of the issue. The question of remedy turned out to be what kept most commentators (or at least us) up at night.

Remedy Roulette

When it came to a remedy, the first and most obvious question concerned whether a Delaware court would *really* go to the mattresses to force a remorseful buyer to close. Certainly, Delaware courts — and Chancellor Kathaleen St. J. McCormick herself — had ordered similar remedies in the past,[12] but none involving deals this large, personalities this big, and companies with the kind of political and social footprint of Twitter. The only other case that resulted in an ordered buyout of a public company, *IBP v. Tyson*,[13] inspired a great deal of handwringing from then-Vice Chancellor Leo E. Strine, Jr. over the potential negative effects on stakeholders like employees, and the extent to which the acrimonious dispute itself might have permanently impaired any working relationships. And IBP did not have nearly the public importance of Twitter.

Second, specific performance is, at core, an equitable remedy available only when legal remedies are inadequate. And though an express stipulation to that effect carries great weight, there remains the reality that a Chancery court has never ordered specific performance for the purchase of a public company in an all-cash sale.[14] An argument could be made that cash damages would, in fact, have been sufficient (assuming they were uncapped), because any cash award to Twitter would be reflected in Twitter's stock price, and those Twitter stockholders who preferred cash would immediately be able to sell their shares on the open market. To be sure, the damages cap in the merger agreement would have plausibly complicated this outcome, but the cap itself likely would not have been part of the calculus as to whether legal remedies were deemed sufficient in the first instance.

Third, by the terms of the merger agreement, specific performance would be ***unavailable*** to Twitter if certain conditions failed, such as the banks' funding of the debt contributions, or lack of approval from regulatory agencies. And Musk himself had a lot of control over whether those contingencies eventuated. To be sure, Chancellor McCormick had — in a case with nearly identical conditions — ordered a reluctant buyer to complete a deal pursuant to the "prevention doctrine" after concluding the buyer had sabotaged its own financing,[15] but there remained questions as to how that would play out if Musk fought every battle. Compounding these issues was the fact that Musk (the natural person) was not contractually obligated to pay anything beyond his specified equity contribution. Only X Holdings — a separate entity with limited liability — was charged with forking over the remaining balance. This raised the question of what would happen if Musk's machinations induced the banks to refuse to fund the debt. Chancellor McCormick could theoretically have ordered specific performance for both Musk and X Holdings, similar to her actions in the prior case, on the ground that Musk himself was responsible for the financing failure; but that would not solve the problem that X Holdings was now roughly $13 billion short of the purchase price and Musk had made no contractual promises to make up the deficiency. Where would the missing funds come from?

Even with those doubts, we conjecture that a specific performance remedy was far and away the odds-on favorite for an outcome, a realization that may even have moved Team Musk to finally settle the matter in late October.

What Did We Learn in the End?

We confess that it first struck us as unlikely that we could conjure much in the way of helpful retrospective commentary on a case that never really looked *all* that hard. Indeed, many of the points offered above do not seem especially controversial. On further reflection, however, we still believe *Twitter v. Musk* has something to offer to those interested in business law (be they transactional or litigation oriented). We offer a few of those insights below.

1. *Even Simple Cases Can Be Made to Look Harder Than They Are*

While the annals of M&A history are replete with examples of remorseful parties groping to find an escape hatch for signed deals, this history typically does not also involve the richest person on the planet. Musk had effectively unlimited resources, coupled with a reputation for fighting endlessly and pugnaciously — often in open defiance of legal requirements — yet frequently coming out on top anyway. Though his case seemed doomed all along on the merits, even a tiny sliver of doubt, particularly about the specific performance remedy, may have rendered worthwhile the hundreds of millions in legal fees expended (not only on his side, but on Twitter's too, since once the deal closed those expenses would effectively become Musk's to bear). Musk could (and did) try to use every bit of that leverage, commencing a prolonged battle, possibly to negotiate a re-cut deal, a termination settlement, or maybe even to shoot the moon and escape the deal entirely.

At the same time, Musk evidently thought there was something to be gained from litigating his case in the court of public opinion. He used his public platform *on Twitter* to accuse Twitter and its executives of fraud and to disparage the company's efforts to fight spam. One of his friends and advisors used his own Twitter platform to performatively respond to a subpoena with vulgarity.[16] Perhaps Musk thought the noise (and the turmoil within Twitter during prolonged litigation) would bring the board to the bargaining table; perhaps he thought he could influence the Delaware courts themselves. But the resulting conflict proved to be irresistible catnip for scores of third parties who entered the fray too, offering opinions (both informed and otherwise) that were shared freely, widely and verbosely (in most cases over Twitter itself). The magnitude and scope of the ensuing punditry tended to disrupt what otherwise would have come off as clear-eyed assessments of what would eventually go on in the courtroom.

2. *A Stress Test for the Twitter Board*

In the early days of the saga, the Twitter board appeared to be a hapless victim of Muskian manipulation. At first, they were objects of ridicule for acceding limply to a semi-sophomoric $54.20 bid; and even when they looked slightly more prophetic as the tech sector slouched, some commenters were still betting that they would quietly walk away for a billion-dollar break fee rather than endure Musk's public barbs. For example, Kara Swisher predicted that the board was "scared," and wanted to "get out of this. They want to get him away from them. What I'd ask is for him to sell back his shares. He sells his shares, maybe at a loss, pays the billion dollars and goes."[17]

Had the board slunk away so meekly, of course, they would have reinforced the general perception of their passivity, maybe even inviting a different species of litigation from Twitter's public shareholders. Instead, however, fight triumphed over flight, as the Twitter board pluckily refused (according to some reports) *any* attempt to recut the price;[18] and, in stark contrast to Musk's mercurial outbursts, they held steady with a strategy of litigating in court filings rather than in in the public arena. As this strategy began to rack up wins during preliminary hearings, the Twitter board transformed in many people's eyes from a calamitous clown car to prophetic paladins. And notably, they stuck to their guns notwithstanding their modest personal financial stakes in Twitter,[19] as well as the likelihood that even if they dropped the lawsuit or settled for a small sum, that decision would receive business judgment deference if subsequently challenged in court. Put simply, they behaved exactly as Delaware expects of boards, relentlessly pursuing the best outcome for Twitter's shareholders, despite any personal tolls, and without prodding from either a financial carrot or a liability stick.

3. *A Victory for Delaware*

Despite the media circus and attempts by Musk's side in particular to blow the dispute up into a far-ranging exploration of every aspect of Twitter's business, Chancellor McCormick consistently played it by the book, issuing early discovery rulings promptly and fairly, refusing to be sidetracked, and maintaining exemplary control over her courtroom. This surprised absolutely no one who had any prior dealings with her. The straightforward conduct of the litigation ultimately burnished both Chancellor McCormick's personal reputation, and Delaware's reputation *writ large* as a no-nonsense litigation venue. That said, it still may have been for the best that Chancellor McCormick was not forced to go all the way to the finish line of a post-trial decision — a process that would have taken many distraction-laden months.

4. *The Mystery of the Merger Arbs*

Despite the seeming weakness of Musk's case — as recognized by almost every legal commenter — the spread between Twitter's market price and the $54.20 deal price remained enormous until nearly the very day the deal finally closed, suggesting that outside of Delaware courtrooms, Musk can still bend gravity in many ways. Beyond throwing (more) general shade on the Efficient Capital Markets Hypothesis as a dependable prophet of pecuniary val-


Chancellor Kathaleen St. J. McCormick

ue, the stubborn durability of Twitter's arb spread raises important questions about its specific drivers here: Was it because arbitrageurs feel uncomfortable making legal judgments — and lawyers simultaneously feel hesitant to quantify outcome probabilities? Was it because of limitations to arbitrage that volatile market conditions fomented? Was it because Musk's army of slavish followers created an aura of invincibility? Did Musk's specific appeal as an insolent, norm-busting, fabulously wealthy techno-bro inculcate a gendered halo effect that systematically afflicted the other finance-bros who make most of the key decisions for merger arbs and hedge funds? This mystery may be one that lawyers, financial analysts and sociologists will take years to unpack.

5. A Bigger Challenge for Corporate Law

Ultimately, however, we think the biggest challenge and puzzle that *Twitter v. Musk* leaves on the table is for corporate law itself. At its core, the purpose of corporate law is to create value — not to destroy it. And though there have been mergers that resulted in value destruction before, in those cases the legal structure provided a glide path for the deal while remaining largely in the background. Here, however, the legal merits largely determined the eventual outcome. It is clear to all (and even Musk himself) that the ultimate decision to close the deal on its original terms crystalized within an ominous shadow of a likely court loss. And yet, other than the now-departed public shareholders of Twitter, it is difficult to know whether *anyone* has been made better off from the deal's closing. And in this regard, the effects on Twitter as a business tell us something about the *social utility* of corporate law.

As of this writing, of course, it's still too early to tell what path lies ahead for Twitter. Musk has caused considerable turmoil and has made many unforced errors thus far in his stewardship of the company; but his champions maintain that there is (or will be) a method to his madness. If Musk succeeds in making Twitter thrive — or even fulfills his ambitions to grow the platform into an "everything app" — it could serve as an important validation of corporate law. If he ends up destroying it, in contrast, it is difficult to sidestep the conclusion that Delaware — despite what seems like a resounding victory in confirming contractual commitments — may also have stumbled into an unforced error of its own. ◆

NOTES

1. https://www.sec.gov/Archives/edgar/data/1418091/000110465922042863/tm2211757d1_sc13d.htm
2. *See* Matt Levine's Money Stuff, "Sure Elon Musk Might Buy Twitter" (April 15, 2022).
3. *See* Item 1.01 of the merger announcement, available at https://www.sec.gov/Archives/edgar/data/1418091/000119312522120474/d310843ddefa14a.htm.
4. *Id.*
5. *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008).
6. *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC*, 268 A.3d 198 (Del. 2021).
7. *See* Merger agreement, supra note 3, at Section 4.25.
8. These declarations are a bit complicated to unpack. Twitter's SEC filings stated that, in its judgment, no more than 5% of mDAU consisted of spam accounts. Musk repeatedly insisted that any platform user would conclude that more than 5% of Twitter's users were spam. But Twitter only represented that it believed its mDAU counts — its estimate of the number of monetizable users — were not off by more than 5% due to spam; it made no representations about how much spam on the platform existed *alongside* monetizable users, such that a user would encounter it in day-to-day usage. Musk's repeated conflation of Twitter's representations regarding its mDAU counts, versus the amount of spam on the platform in total, either demonstrated that Musk did not rely on the mDAU numbers because (as he claimed) they were facially false, or that Musk did not rely on the mDAU numbers because he did not understand how they were calculated.
9. *Wind Point Partners VII-A v. Insight Equity A.P. X Co.*, 2020 WL 5054791 (Del. Super. Aug. 17, 2020)
10. "The Securities Act" Texas Acts 1957, 55th Leg., p. 575, ch. 269, Sec. 1.
11. *See Twitter v. Musk, et al.*, Defendants' Verified Amended Counterclaims, Answer, and Affirmative Defenses to Plaintiff's Verified Complaint, C.A. No. 2022-0613-KSJM, at p. 87 (Aug. 4, 2022).
12. *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*, 2021 WL 1714202 (Del. Ch. April 30, 2021).
13. *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 14 (Del. Ch. 2001).
14. The IBP-Tyson transaction was a mixed cash and stock deal. *Id.* Moreover, none of the cases ordering specific performance was ever affirmed by the Delaware Supreme Court.
15. *Snow Phipps Group*, 2021 WL 1714202 at *52-56.
16. The humor of which was not appreciated by Chancellor McCormick. *See Twitter v. Musk, et al.*, 2022 WL 4004148 (Del. Ch. Sept. 2, 2022).
17. *The Twitter Lawsuit Could Be Very Bad for Elon Musk*, NEW YORK MAGAZINE, July 12, 2022 (available at https://nymag.com/intelligencer/2022/07/the-twitter-lawsuit-could-be-very-bad-for-elon-musk.html).
18. Kate Conger & Lauren Hirsch, *The Board Chair Squaring Up to Elon Musk in the Feud Over Twitter*, N.Y. Times, Oct. 4, 2022 (available at https://www.nytimes.com/2022/10/04/technology/twitter-board-elon-musk.html).
19. As far as we can discern, other than a representative of Silver Lake (a major Twitter investor) and Twitter co-founder and former CEO Jack Dorsey, none of Twitter's directors had significant stakes in the company. *See* Twitter Schedule 14A, filed Apr. 12, 2022, https://www.sec.gov/Archives/edgar/data/1418091/000114036122014049/ny20001921x3_def14a.htm