

The SEC's Recent Settlement with Tesla and Elon Musk Teaches Us a Valuable Corporate Governance Lesson

October 3, 2018 – Cross-Border Counselor

by Christopher L. Doerksen

The SEC's settlement with Tesla and Elon Musk teaches us some important corporate governance lessons on monitoring and vetting executive use of social media.

As background, on August 7, 2018, the markets were surprised by a series of tweets initiated by Elon Musk, the CEO of Tesla, Inc., in which Musk mused about taking Tesla private at \$420 per share (a significant premium to the then-market price), with funding secured. The stock price jumped, trading in Tesla stock was halted, and Tesla rushed to catch up with official announcements. The deal didn't happen, and it was questioned whether Musk was really serious, and whether funding was really "secured." The SEC commenced an investigation.

On September 27, 2018, the SEC announced charges against Musk for securities fraud in connection with his tweets, which it said were inaccurate and misleading. Among the remedies sought was a permanent ban on Musk being eligible to serve as a director or officer of any public company, effectively seeking to sever him from Tesla, a company of which he is the heart and soul. Tesla's stock dropped 14%. If this remedy was included by the SEC as leverage, that leverage worked, and on September 29, 2018, the SEC announced a settlement with Musk, as well as charges against and a settlement with Tesla. Tesla's stock increased 17%.

As part of the settlement, Musk will remain Tesla's CEO and a director, but Musk and Tesla agreed that:

- Musk will step down as Tesla's Chairman for at least three years and be replaced as Chairman by an independent director;
- Tesla will appoint two additional independent directors;
- Tesla will establish a committee of independent directors and put in place additional controls and procedures to oversee Musk's communications; and
- Musk and Tesla will each pay \$20 million to harmed investors under a court-approved process.

Related People

- Christopher L. Doerksen

Related Capabilities

- Canada Cross-Border Transactions

The SEC alleges that Tesla failed to implement adequate disclosure controls and procedures over Musk's use of Twitter. Tesla had publicly announced in 2013 that Musk's Twitter account would be among the means by which Tesla intended to release material information, Musk had amassed 22 million Twitter followers, and important information about Tesla had been released through this account, but the SEC says that Tesla had not adopted any specific policies regarding Musk's use of Twitter, such as procedures to determine whether proposed tweets were accurate and complete, and whether they contained information requiring disclosure in Exchange Act reports. In effect, the SEC says Tesla had given Musk carte blanche to release material information about Tesla, without subjecting it to the normal controls to which other, more formal, types of disclosures would be subject, and as a result, the market was misled. Investors harmed included short sellers and those who purchased shares after Musk's announcement temporarily drove up stock prices, only to see those prices drop afterwards.

The SEC's settlement with Tesla and Musk teaches us some important corporate governance lessons:

1. If a public company allows its executives to use Twitter or other social media accounts to disclose material information about the company, it is not enough to notify the public that material disclosures may be made by these means. Companies must ensure that their disclosure controls and procedures adequately cover executives' use of social media.
2. In deciding what disclosure controls and procedures to implement, consideration should be given to such matters as:
 - a. what topics are permitted or prohibited;
 - b. procedures for review and approval of disclosures before they are made;
 - c. the inclusion of risk factors or other cautionary or explanatory language to help prevent disclosures from being potentially misleading;
 - d. coordination of social media disclosures with other company disclosures as needed to satisfy public reporting requirements; and
 - e. monitoring actual disclosures and resulting market and media reactions for any surprises.
3. Companies that do not allow executives to use social media accounts to disclose material information should adopt policies clearly prohibiting such use, and monitor executives' use of social media for any inadvertent violations of policy.