SECURITIES – SECURITIES FRAUD

The United States District Court for the North District of California held that Plaintiffs plausibly alleged that Elon Musk violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 enacted thereunder by making multiple misrepresentations to artificially depress the price of Twitter stock to lower its acquisition price. *Pampena v. Musk*, No. 22-CV-05937-CRB, 2023 U.S. Dist. LEXIS 220240, 2023 WL 8588853 (N.D. Cal. Dec. 11, 2023).

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In *Pampena v. Musk*, former stockholders of Twitter ("Plaintiffs") alleged that Elon Musk ("Musk") violated Section 10(b) of the Securities Exchange Act. Since the Act's enforcement in 1948, Congress raised the pleading requirements on allegations of securities fraud to discourage frivolous lawsuits.[1] Despite this heightened pleading requirement, the Court found the Plaintiffs plausibly alleged instances of securities fraud and both granted and denied in part Musk's motion. In particular, the Court found that Plaintiffs succeeded in pleading that some of Musk's Tweets and

[1] 1 SEAN MURPHY ET AL.., MATTHEW BENDER'S FEDERAL SECURITIES EXCHANGE ACT OF 1934 § 5.04 (Matthew Bender, rev. ed. 2024); 15 U.S.C. § 78u-4(b); Tellabs, Inc. v. Major Issues & Rights, Ltd., 551 U.S. 308, 321 (2007). Under the Federal Rules of Civil Procedures, a heightened pleading standard for alleged fraud is also required. FED. R. CIV. P. 9(b).

Statements were (1) material misrepresentations,[2] (2) made with the required state of mind,[3] and (3) directly or substantially related to Plaintiff's loss.[4]

I. FACTUAL BACKGROUND

On March 26, 2022, Elon Musk began discussing the website's direction with Twitter executives.[5] After internal discussions and meetings at Twitter, the Company appointed Musk to the board.[6] Before the appointment became effective, Musk notified the chairman of Twitter's Board and CEO that he would instead be offering to take Twitter private.[7]

Later, Musk submitted an amended Schedule 13D stating that he was exploring whether to commence a tender offer.[8] The Schedule 13D said Musk no longer conditioned his offer on financing or subjected the offer to

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[2] Pampena v. Musk, No. 22-CV-05937-CRB, 2023 WL 8588853, *9–14 (N.D. Cal. Dec. 11, 2023).
[3] *Id.* at *15–18
[4] *Id.* at *18–20.
[5] *Id.* at *1.
[6] *Id.*
[7] *Id.*
[8] *Pampena*, 2023 WL 8588853, at *2.

due diligence as set out in the original terms.[9] On April 25, 2022, Twitter entered into the Merger Agreement. Musk announced the merger the next day and promised to "defeat the spam bots."[10] Musk used his Tesla stock as collateral to partially fund the deal amongst other measures.[11]

In the weeks following, Musk sent several tweets, letters, and notices regarding the deal which became the subject of the lawsuit. The most important to the case are the Tweets on May 13 and 17, 2022, and a statement made on May 16, 2022.[12] On May 13, 2022, Musk tweeted that the Twitter deal was on hold pending details supporting calculations of the number of fake/spam accounts.[13] On May 16, 2022, Musk stated at a tech conference that fake and spam accounts comprised at least 20% of Twitter's users.[14] On

[9] *Id.*
[10] *Id.* at *3.
[11] *Id.*
[12] *See id.* at *3–4.
[13] *Id.*
[14] *Pampena*, 2023 WL 8588853, at *4.

May 17, 2022, Musk tweeted that the number of fake accounts on Twitter could be more significant than 20% and that the deal would not go forward until proven otherwise. Following each of these tweets and the statement, Twitter stock declined.[15] After several notices of termination sent by Musk, Twitter sued him in Delaware Chancery Court over his termination of the deal (the "Delaware Action").[16]

Plaintiffs sued, alleging Musk violated Section 10(b) of the Securities Exchange Act by making multiple misstatements to depress the price of Twitter stock artificially and to lower Twitter's acquisition price.[17] Plaintiffs filed the original class action complaint on October 10, 2022, and subsequently filed an amended complaint, which Musk moved to dismiss.[18]

[15] *Id.*
[16] *Id.* at *4–5.
[17] *Id.* at *1, *6.
[18] *Id.*

II. ISSUE

Plaintiffs alleging securities fraud from statements under Section 10(b) of the Securities Exchange Act must plausibly plead the following: "(1) a material misrepresentation or omission; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance on the misrepresentations; (5) economic loss; and (6) loss causation…."[19] However, here, the elements of (1) material misrepresentation, (2) scienter, and (3) loss causation were at issue.[20]

III. REASONING AND HOLDING

In *Pampena v. Musk*, the Court denied Musk's motion to dismiss as the plaintiffs plausibly alleged elements of securities fraud under Section 10(b). The Plaintiffs plausibly plead that Musk made (a) statements that gave

[19] *Pampena*, 2023 WL 8588853, at *9 (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005)).
[20] *Id.* at *9.

materially different impressions of the facts and implied information that impacted the market; (b) had the culpable mental state that showed at least a deliberate recklessness to mislead; and (c) established a connection between their economic loss and the misrepresentations by Musk.

A. MATERIAL MISSTATEMENT

To prove a statement was a material misrepresentation, the Court relied on the reasonable investor standard. A statement is misleading under this objective standard "if it would give a reasonable investor 'the impression of a state of affairs that differs in a material way from the one that. . . exists.'"[21] For materiality, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable

[21] *Id.* at *10 (quoting Berson v. Applied Signal Tech., Inc., 527 F.3d 982, 987 (9th Cir. 2008)).

investor as having significantly altered the 'total mix' of information available."[22]

The Court only determined that the tweets on May 13 and 17 and the statements on May 16 could be materially misleading as the Plaintiffs adequately pled materiality and falsity. For the May 13 tweet, the Court found that Musk gave a materially different impression from the actual state of affairs because the Plaintiffs plausibly alleged that he waived due diligence as a condition of the merger agreement.[23] Thus, Twitter had no obligation to provide information regarding its bot/spam calculations, so Musk's representations were false.[24] Additionally, under the reasonable investor

[22] *Id,* at *9 (quoting Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988)).
[23] *Id.* at *10.
[24] *Id.*

standard, a reasonable investor would find Twitter not complying with its contractual obligations material to their investment decision-making.[25]

The Court also concluded that Musk's May 16 statement could be materially misleading as Plaintiffs adequately pled the materiality and falsity of the statement.[26] His statement on bots constituting 20% of Twitter users misled the public to believe that Musk received and was basing this comment on actual bot user data from Twitter, which was not the case.[27] The Court believed that a reasonable investor would likely find such access to and further findings about Twitter's user makeup material to their investment strategy, especially in light of the May 13 tweet.[28]

[25] *Id.* at *11.
[26] *Pampena*, 2023 WL 8588853, at *12.
[27] *Id.*
[28] *Id.*

Finally, the Court ruled that the May 17 tweet was a material misrepresentation.[29] The statements regarding the percentage of fake accounts were false due to investors assuming the receipt of new knowledge of the bot totals, like that of the May 16 statement; however, the statements regarding Twitter's obligations were false as a parallel to the May 13 tweet, which misrepresented the waiver of due diligence.[30] The Plaintiffs plausibly alleged that Musk falsely implied access to material information regarding the bot/user mix and falsely implied that Twitter was obligated to provide the requested information despite the waiver.[31]

B. SCIENTER

The Court next addressed whether Musk acted with the required state of mind. Scienter is a mental state that displays an "intent to deceive,

[29] *Id.* at *13.
[30] *Id.*
[31] *Id.*

manipulate, or defraud."[32] The Court held that to demonstrate scienter the Musk must have "contemporaneously made 'false or misleading statements either intentionally or with deliberate recklessness.'"[33] Deliberate recklessness is "an extreme departure from the standards of ordinary care" that either Musk knows misleads investors or is so obvious that he should have been aware of it.[34] The Court stated that to plead scienter adequately, the complaint has to "state with particularity facts giving rise to a strong inference that Musk acted with the required state of mind."[35] This determination involves a dual inquiry where the court examines whether each

[32] *Pampena*, 2023 WL 8588853, at *15 (quoting *Tellabs,* 551 U.S. at 319).
[33] *Id.* (quoting Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 991 (9th Cir. 2009)).
[34] *Id.* (quoting Alphabet Secs. Litig., R.I. v. Alphabet, Inc., 1 F.4th 687, 701 (9th Cir. 2021)).
[35] *See* 15 U.S.C. § 78u-4(b)(2)(A); Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc., 759 F.3d 1051, 1061 (9th Cir. 2014).

of the plaintiff's allegations alone gives rise to scienter, or whether under a holistic review, they combine to give a strong inference of scienter.[36]

For the tweets and the statement, the Court found that the Plaintiff's allegations, under a holistic review, gave rise to a strong inference of scienter.[37] Musk's heavy involvement in the merger agreement and earlier tweets that indicated his awareness of the bot/spam account issue made it "at least" deliberately reckless not to investigate whether Twitter had an obligation to turn over relevant data.[38]

Further, the financial pressure faced by Musk after the decline in Tesla stock that he posted as collateral and a statement admitting "he did not want to pay the $44 billion" indicated a motive to terminate the deal.[39]

[36] *Pampena*, 2023 WL 8588853, at *15 (citing Glazer Cap. Mgmt., L.P. v. Forescout Techs., Inc., F.4th 747, 766 (9th Cir. 2023)).
[37] *Id.*
[38] *Id.* at *16.
[39] *Id.* at *17.

Relying on precedent, the Court stated that a court can consider allegations of motive in combination with other allegations of scienter, but motive alone will not suffice.[40] The Court held that this motive "should be considered alongside other allegations of scienter."[41]

Finally, during the Delaware Action, Musk made statements consistent with his belief about the merger agreement that the deal could not move forward if Twitter did not provide specific data.[42] However, despite this consistency, the Court was persuaded by the factual comparison to *Glazer*'s determination of scienter that found scienter when the defendant was aware of information that rendered their statements about the merger misleading despite their subject belief.[43] Here, despite Musk making

[40] *Id.* (citing Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940, 949 (9th Cir. 2005)).
[41] *Id.*
[42] *Id.* at *17–18.
[43] *Pampena*, 2023 WL 8588853, at *18 (citing Glazer Cap. Mgmt., L.P., 63 F.4th at 780).

statements that were subjectively consistent with his belief regarding data provision in the Delaware Action, Musk's actions in that lawsuit were still considered holistically alongside Plaintiffs' other allegations of scienter.[44] The Court considered his statements in the Delaware Action because the Plaintiffs alleged facts that raised a strong inference that Musk knew or recklessly disregarded the fact that he had material information, such as his waiver of due diligence, that would make his statements false or misleading.[45]

C. LOSS CAUSATION

The Court considered the next disputed element of loss causation, which the Plaintiffs here plead under a corrective disclosure theory.[46] A corrective disclosure theory must reveal new statements, taken as true, that make a "[D]efendant's prior statements false or misleading."[47] These

[44] *Id.*
[45] *Id.*
[46] *Id.* at *19.
[47] *Id.* (quoting In re Bofl Holding, Inc. Sec. Litig., 977 F.3d 781, 790 (9th Cir. 2020)).

previous or misleading statements then must be directly related to the actual economic loss the Plaintiff suffered, or, at the least, a substantial factor in causing the loss.[48]

Twitter stock declined following the tweets and statements that were material misrepresentations.[49] This decline impacted the Plaintiffs' position as they sold their positions when the stock was depressed.[50] Under the corrective disclosure theory, Plaintiffs alleged that Twitter's stock price increased steeply once Musk disclosed his misrepresentations to the market, which it did.[51] The market reasonably reacted to the true disclosure that Twitter was never obligated to provide user information when Musk decided

[48] *Id.* at *18 (citing Nuveen Mun. High Income Opportunity Fund v. City of Alameda, 730 F.3d 1111, 1120 (9th Cir. 2013)).
[49] *Pampena*, 2023 WL 8588853, at *19.
[50] *Id.*
[51] *Id.*

to proceed with the deal.[52] From this, the Court found the Plaintiffs successfully alleged facts connecting their loss to Musk's misstatements.[53]

Musk argued that even if Plaintiff's complaint stated viable security fraud claims, the petition would still fail due to the Noerr-Pennington Doctrine.[54] Under the Doctrine, "those who petition any department of the government for redress[, such as through the courts,] are generally immune from statutory liability for their petitioning conduct."[55] The Court found this unconvincing and held that "there is plainly not an 'intimate relationship between Musk's tweets or his May 16 conference statement and "the actual

[52] *Id.*
[53] *Id.* at *20.
[54] *Pampena*, 2023 WL 8588853, at *20.
[55] *Id.* (quoting Sosa v. DIRECTTV, INC., 437 F.3d 923, 929 (9th Cir. 2006)).

litigation process."[56] Tweeting and publicly speaking about a transaction are not the actions that arise in the context of "petitioning activity."[57]

The Court concluded the Plaintiffs sufficiently pleaded enough facts to state a claim of relief that is plausible on its face despite the heightened pleading under section 10(b) of the Securities Exchange Act.[58] Specifically, the Court found the Plaintiffs plausibly alleged that the Musk's tweets on May 13 and May 17 and his statements on May 16 were material misrepresentations.[59] From a holistic view, the Court found a strong inference of Scienter in that the Musk intentionally or was at least deliberately reckless in making materially false statements.[60] Finally, the Court found

[56] *Id.*
[57] *Id.* (referencing *Sosa*, 437 F.3d at 936). Instead, the Court provided the following examples: "pre-suit demand letters…; discovery communications…; [and] the refusal to enter into settlement negotiations…." *Id.* (citations omitted).
[58] *Pampena*, 2023 WL 8588853, at *21.
[59] *Id.* at *11–13.
[60] *Id.* at *15.

Plaintiffs pleaded sufficient factual allegations that the May 16, 2022 statements plausibly caused the Plaintiff's loss.[61]

IV. CONCLUSION

Tennessee transactional attorneys should note the level of proof required for the heightened pleading requirements to plausibly allege securities fraud under the Security Exchange Act. This case provides an example of how to plausibly allege material misrepresentations, scienter, and loss causation. Interestingly, practitioners should also consider that the court may not consider the public filing of the merger document to be a public declaration of obligations in the 8-K dated April 25,[62] and instead may rely on inferences about the obligations found under the October 4, 2022, 13D filing that the deal will continue.[63] Perhaps practitioners should expect the

[61] *Id.* at *20.
[62] *See id.* at *6.
[63] *Id.*

Court, when dealing with loss causation related to highly public takeovers by billionaires, to not rely on 8-K filings for public announcements and instead look at the public disclosure of a Schedule 13D coupled with a drastic market reaction.