Critical Analysis of Elon Musk's takeover of Twitter

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Abstract. According to the latest news, Musk completed the acquisition of Twitter on 27 October, which is a foreseeable result of this paper. This paper will critically discuss how the parties of this deal achieved their results, terminating the transaction for Musk and continuing the trade for Twitter by reviewing the agreements' representations, warranties, and covenants, MAC, the case of *Snow Phipps Group v KCAKE* and Verizon v Yahoo acquisition, will be referred. Musk previously would like to terminate the transaction because Twitter has provided false statements despite Musk skipping the due diligence (business/finance, legal/regulatory, environmental, and other areas of the target company) of the acquisition of Twitter. Then, Musk added the whistleblower's allegation about Twitter's security holes to the list of reasons for the deal's termination. The intention of ending might be that Musk would purposely reduce his offer price from $44 billion to a lower price by threatening to cancel the acquisition if Twitter permitted the transaction to proceed in subsequent negotiations if Twitter is liable for breach of representations and warranties. As for the acquisition agreement's covenant, the essence of the deal is access rights, which allowed Musk to acquire additional information after the contract closing, and Twitter had performed its obligations under the agreement. As last, Twitter argues that the market decline did not trigger the MAC clause. Therefore, the deal should proceed as planned.

Keywords: Musk v Twitter takeover; representations & warranties; covenants; MAC/MAE clause; specific performance.

1. Introduction

Elon Musk stated that he would officially terminate the $44 billion (£37.7 billion) offer to take over Twitter on July 8 due to Twitter's "far-reaching conduct." Musk's decision could base on the representations and warranties that Twitter provided false statements on Twitter's security and data protection while referring to Verizon's acquisition of Yahoo after Yahoo's data breach, in which the addition of Yahoo was conducted with a $350 million less than the original offer price. On the other hand, Twitter could force the purchase to continue as Musk revoked the takeover after signing the merger agreement based on the covenants and specific performance of the contract.

2. Background

2.1 Timeline

On April 5, 2022, the Twitter CEO announced that Elon Musk would join the Twitter Board.

On April 11, 2022, Tesla CEO Elon Musk offered $41.39 billion to Twitter to purchase the shares at $54.20 per share. This offering suggested the price demonstrates a 38% premium over the share price of Twitter as of 1st April, which was the last trading day before Elon Musk made the purchase.

On 25 April 2022, the board of Twitter finalised a $44 billion sale agreement with Musk. On May 17, According to Musk, the Twitter acquisition would only go through if the company provided information about bots. On June 6, Musk threatened to cancel the Twitter agreement, claiming that Twitter had failed to provide the necessary details regarding spam bot accounts. On July 9, the Tesla CEO announced his intention to withdraw from the Twitter deal in an SEC filing. On July 11, Twitter hired Wachtell, Lipton, Rosen & Katz to represent them in a lawsuit against Elon Musk. Quinn Emanuel Urquhart & Sullivan will represent Musk in that lawsuit. On July 29, a Delaware judge ruled that Twitter's lawsuit against Musk over his decision to terminate their $44 billion acquisition agreement would begin on October 17 and last for five days [1].

2.2 Twitter data breach and Whistle-blower

Twitter stated that its systems were attacked due to a zero-day flaw. This attack allowed the leaking of users' email and phone numbers, which was considerable damage to the business and benefit of users. As the database of Twitter contains 5.4 million users, it suggests that attackers could develop a new database with the information collected. Users of Twitter provide their information of email addresses or phone numbers when registered, which indicates that it is an excellent opportunity for Twitter to keep users' private information confidential [2].

This is particularly concerning for platform users who would like anonymity. Twitter recommends that users who wish to remain anonymous do not link a phone number or email address publicly accessible to their account.

On August 23, 2022, Zatko, whom Twitter fired in January, filed a whistleblower complaint against the company on August 23, 2022, alleging that it was "grossly negligent in multiple areas of information security [3]."

Elon Musk emphasised the importance for Twitter to pay attention to the data leaking issue and decided to terminate the investment of $44 billion on social media networks and requested to postpone a trial linking to the deal in September 2022.

Representatives of the CEO of Tesla stated that former head of security Peiter Zatko's allegations of "extensive misconduct" at Twitter constituted an additional breach of contract. According to the attorneys' Musk, in a letter to Twitter, the claims of the data leakage suggested that Twitter violated the merger agreement.

Musk has served Zatko with a subpoena requiring him to testify regarding the contract's termination in a trial. Musk asked the Delaware court of chancery to postpone the case hearing to November 10th. According to CNN and Verge, Zatko's disclosures accompanied his request for a postponement.

According to Zatko, about one-third of the laptops of Twitter were subjected to blocked updates automatically to ensure that fixes were done. The current system is venerable, which explains the hacking. Additionally, Zatko asserts that the board of directors of Twitter was misinformed regarding the vulnerabilities [4].

3. Acquisition agreement

3.1 Representations & Warranties

Mask claimed that Twitter had not provided the information he requested, which inviolate the merger agreement. Whereas Twitter appears to have provided Musk with a certain amount of data, and the obligation in the deal is not without limits.

Musk argues that Twitter has materially exaggerated the number of spam and bot accounts [5]. This is the most serious allegation that Twitter has lied for years in its securities filings and will be vigorously contested. Moreover, the recent news about the whistleblower alleged that Twitter had acknowledged the data breach and security holes contributing to a solid argument that Twitter provided a false statement violating the merger agreement, significantly since the data breach of Twitter would affect 5.4 million users.

Finally, Twitter has failed to conduct its business in the "normal course" primarily due to the dismissal of two high-level employees. This is a weak argument for reversing a $44 billion deal.

Referring to the deal between Verizon and Yahoo, Verizon acquires Yahoo's internet business to expand its platform before the data breach. After the data breach, Verizon lowered the offer price to conduct the merger based on representations and warranties that Yahoo held false statements in the due diligence step-yahoo had acknowledged the leakage of data, including the user's name and password.

Hence, Musk would intentionally achieve a reduced offer price-$44 billion to a lower price by threatening to terminate the takeover if Twitter would enable the transaction to proceed in a later negotiation.

3.2 Covenants

Usually, target companies have the right to request additional information about the acquired companies before signing the purchase agreement. It is not typically the most contentious or heavily negotiated provision. After entering into a purchase agreement, it is generally accepted that a buyer has additional tasks to complete, which may require additional information.

As stated in the merger agreement between Twitter and Elon Musk, Twitter agrees to provide additional information if it is reasonable and valuable to help close the transaction. The primary dispute concern demonstrated in the agreement is the scope and the access right. The interpretation of the term "related to the consummation of the transaction" [6] might be of different senses by Elon Musk's team. However, the purpose of the request for data should be to facilitate the closure of the transaction. Alternately, Musk may request that the access rights be broadly construed to permit him to conduct a thorough investigation into an alleged or suspected breach of representation. Musk's attorneys stated in response to Twitter that the negotiation of the access right is essential because they could conduct due diligence upon signing the agreement.

Musk said that Twitter should clarify the number of spam-bot accounts on social networking sites.

Especially with a buyer like Musk, his business purpose is not to develop a competitor in the social media network, which implies that he would not need insider information and business intelligence. However, a buyer needs to have access to sufficient information to decide on terminating the acquisition. Twitter could counter the whistle-blower's claim that the security issue was defamation by asserting that it had met its obligations under the merger agreement.

There are a few valid reasons why a broad interpretation of this access right would make most targets uneasy. To begin, it is more common for due diligence to occur before a legally binding agreement is announced rather than after. The closing of the Twitter merger was not contingent on the results of a due diligence investigation. It is not commonly believed that the access covenant provides an opportunity for the purchaser to attack the business of Twitter in the process of conducting due diligence.

In *Fairstone Financial v. Duo Bank*, the Ontario Superior Court of Justice has recently ruled on this issue. In this instance, the buyer repeatedly requested information from the seller, most of which occurred after the buyer claimed the seller had breached the merger agreement. In addition, the court in the case of Duo determined that the multi-requests of information were invalid and unnecessary to complete the transaction. It will be intriguing to see how this significant dispute between Twitter and Mr Musk is resolved in Delaware [7].

Based on the information presented above, it is noticed that the most critical lesson for M&A attorneys to learn is drafting the access covenant and avoiding using open-ended covenants. In the example of Twitter, it is understood that requesting all information reasonable for closing the transaction might bring issues to Twitter. It is challenging to determine whether there is a good reason to believe in the purpose of the purchasers to request the information needed to close the transaction.

3.3 MAC/MAE Clause

Typical acquisition contracts contain provisions designed to protect the parties' interests. The MAE clause allows the acquirer to terminate a transaction if a materially adverse event threatens its commercial interests.

The drafting of MAE clauses should accurately reflect the parties' commercial intent. Standard MAE clauses should not be utilised.

Termination is only permissible if the MAE significantly impacts the transaction. It may take more than a general decline in the stock market to save the day.

In addition, the parties' conduct between the signing and closing of a contract can significantly determine whether an MAE clause is being abused.

Musk decided not to acquire Twitter and terminate the agreement because Twitter demonstrated inaccurate representations (particularly concerning fake Twitter accounts), triggering the MAE clause due to a materially adverse event.

Twitter has contested Musk's dismissal and refuted his claims of misrepresentation. Twitter has also claimed that Musk is attempting to back out of the deal because of the market downturn and hence the decrease in the price of the stocks. Based on the qualitative thresholds demonstrated in the clauses, Twitter has argued that the MAE clause was not the trigger of the market decline.

Nonetheless, it is critical to reference the business laws in America. There were examples when the target company’s financial perspective influenced the MAE clauses. According to the Delaware court, the clause threatens the long-term economic gains of the acquirer in the long run. Hence, an examination was conducted based on the consideration of the actions of the acquirer. As demonstrated in the case of *Akorn, Inc. v. Fresenius Kabi*, the Delaware court ruled that the termination was legal as the acquired fulfilled the obligations while the purpose was for closing the transaction. Meanwhile, quantitative and qualitative materiality tests were conducted to implement the MAE clause [8].

3.4 Specific performance

Generally, specific performance is ordered when damages are insufficient. The argument for Twitter could be that the merger agreement expressly requires a particular version and that this is a "once in a lifetime" opportunity to maximise shareholder value (Musk's offer was $54.20 per share, whereas the current market price is $32.55). This is an audacious attempt to avoid a legally binding agreement, and the courts should hold Musk accountable [9]. The merger agreement cannot be terminated because of buyer's remorse over a high price or increased funding costs.

There are three particularly intriguing aspects of specific performance order. First is the function of the banks, which would be required to provide $13 billion in financing via commitment letters. How would the Delaware courts feel if banks were (indirectly) ordered to give this type of funding? Such an order could lead to satellite litigation to determine whether the banks must provide the committed financing. Second, there is the issue of being "above the law." What if Mr Musk is ordered to perform a specific task and refuses? The courts might then find him in contempt and sentence him to jail. Mr Musk now resides in Texas and appears to have the support of the state's attorney general, who has launched an investigation into Twitter's bot issue. Third, there is the question of public policy: how would the Delaware courts weigh the significance of upholding merger agreements versus compelling an unwilling buyer to complete? The chancellor of Delaware, who must decide this case, will face challenging questions (if it makes it that far) [10].

4. Literature/case References

4.1 Snow Phipps Group v KCAKE acquisition

Kohlberg & Company, LLC (Kohlberg) and Snow Phipps Group, LLC (Snow Phipps) reached an agreement for Kohlberg to acquire DecoPac Holdings Inc. on 6th March 6, 2020. It was the beginning of the COVID-19 pandemic in America (DecoPac). This company provides supermarket bakeries with cake-decorating ingredients and supplies. Within a few weeks, the buyers "lost interest in the transaction" because of the lockdowns ordered by the government, which suggested the business decline of DecoPac.

Kohlberg was pessimistic, although DecoPac's executives anticipated a sales increase. Kohlberg predicted sharp drops in the business of DecoPac when the influence of the pandemic was on, which suggested that DecoPac could do nothing to follow the government's instructions. Instead of DecoPac's forecasts, Kohlberg's were provided to lenders, and the firm demanded modifications to the financing. The lender denied the requests. Kohlberg informed Snow Phipps that it was impossible to close the transaction, and Kohlberg subsequently filed a counterclaim. Snow Phipps was interested in specific performance.

Kohlberg claimed that the share purchase agreement could have been terminated based on DecoPac's performance because of the impacts of the pandemic (SPA). The result of the 5-day trial was that Kohlberg's claim was rejected. First, Kohlberg could not establish an MAE's existence because DecoPac's performance started to improve shortly before the termination was raised, which indicated that there needed to be solid ground when the request was brought up. Secondly, the plaintiffs demonstrated that government shutdown orders were primarily responsible for the performance decline. Thus, one of the exceptions listed in the SPA applied to the effects of COVID-19. Kohlberg was required to demonstrate that DecoPac's losses were disproportionate to those of its competitors.

After the court dismissed Kohlberg's MAE claim, the alternative claim that Snow Phipps breached the agreement was also rejected. After dismissing Kohlberg's MAE claim, the court dismissed Kohlberg's alternative claim that Snow Phipps had violated its agreement to continue operating the DecoPac business normally.

After rejecting Kohlberg's justifications for the failure to close, the court agreed with Snow Phipps on its counterclaim, finding that Kohlberg was in breach of its duty to make sufficient efforts to secure financial results. Under the terms of the SPA, the court instructed a $550 million acquisition.

After resolving several factual issues, the court determined that these fundamental issues did not need to be resolved due to the explicit language of the contract. Notably, the court rejected Kohlberg's claim that by rejecting Snow Phipps' claim and the inclusion of "epidemics" and "pandemic" in MAE, it had unambiguously assigned that DecoPac did not know the coming risks of the Covid-19 pandemic. In contrast, the court determined that Kohlberg intentionally shifted the pandemic's risks to DecoPac [11].

4.2 Yahoo v Verizon: Data Breach

A close look into the two massive data breaches of companies last year revealed new terms between Yahoo and Verizon: Verizon offered $50 million less than the original offering to acquire Yahoo. Besides, according to the new terms, these two companies agreed to exchange legal and regulatory liabilities. Yahoo's data breach was reported to impact over 500 million accounts in December 2016 [12]. TechCrunch confirmed that Altaba would assume any remaining Yahoo liabilities. After Verizon acquired the company's remaining assets, this newly rebranded holding company will manage Yahoo's stake in Alibaba. Yahoo stated that the company would remain responsible for potential shareholder lawsuits and SEC investigations, especially when 50% of any cash liabilities are demonstrated [13].

5. Conclusion

First, Musk claims that Twitter has not given him the requested data, violating the merger agreement. Whether or not Twitter gave Mr Musk a substantial amount of information is a question, but it appears it did. Twitter's obligation under the deal is not without limits.

Musk claims that Twitter has grossly exaggerated the number of fake or spam accounts. Essentially, Twitter has been lying for years in its security filings, making this the most serious allegation and one that will be vigorously defended against. The accusation is worded very vaguely: "Mr Musk has reason to believe." Prominent observers (like Bloomberg's Matt Levine) have questioned the veracity of Mr Musk's complaint, noting that the bot problem was one of the reasons he decided to purchase Twitter.

Third, by terminating the employment of two executives, Twitter has deviated from the "ordinary course" of its business. This seems like a weak ground (on its own) to cancel a $44 billion agreement.

Musk could insist that Twitter held incorrect information or did not provide the security of data, actual numbers of active users, moreover a data breach, according to the whistle-blower, which allowed Musk to terminate the offer and cancel the transactions.

Therefore, according to the latest update, Musk decided to continue the takeover of Twitter if Twitter dropped its lawsuit and completed this $44 billion purchase of Twitter.

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