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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

# Musk, Tesla Board Face Chancery Suit Over 'Erratic' Conduct

By **Jeff Montgomery**

Law360 (October 17, 2018, 9:24 PM EDT) -- Pointing to unchecked, "erratic" behavior by Tesla founder Elon Musk and board failures to head off recent, costly consequences, a company shareholder launched a derivative suit in Delaware's Chancery Court on Wednesday, seeking damages and governance reforms.

Tesla founder Elon Musk and eight board members were hit with a suit alleging breach of fiduciary duty, unjust enrichment and gross mismanagement. (AP)

The three-count proposed class suit, led by stockholder Zachary Elton, was filed one day after a federal judge approved matching, $20 million Securities and Exchange Commission fines against Tesla and CEO Musk for misleading investors, via Twitter, about taking the electric car maker private on Aug. 7 and for several days afterward.

Musk, Tesla's chief financial officer and eight board members were accused of breaching their fiduciary duty, unjust enrichment and gross mismanagement in the suit. The derivative action was filed to recover damages on behalf of the company based on board failures to act and an alleged lack of independence from Musk among a majority of directors due to extensive business and personal ties to the chief executive.

"Despite being put on notice of E. Musk's propensity for erratic public communications that have harmed the company and its stockholders, the board consciously disregarded his actions and failed to do anything," the suit said. "The board put their loyalties to E. Musk ahead of their fiduciary duties to the company and its shareholders."

In September, the SEC alleged that Musk falsely claimed in a series of tweets on Aug. 7 that he had lined up funding and support to take Tesla private at $420 per share, with backing from Saudi Arabia's public investment fund. The announcement boosted Tesla's stock price about 6 percent to close at $379.57 a share that day, although the price has since fallen 28.4 percent, to $271.78, as of Wednesday evening.

The SEC also required Musk to step down as chairman for three years, required the company to appoint two new independent directors and establish new corporate controls — including for oversight of Musk's communications — and directed the company to hire a securities lawyer to review social media communications by Musk and senior officers.

Tesla's "materially inadequate" controls "substantially damaged the company's credibility, corporate image and goodwill," the complaint said, adding that Tesla had "no controls or procedures whatsoever" concerning Musk's tweets or the need to file them with the SEC.

The derivative action seeks damages for the compensation and benefits paid to those named, costs incurred as a result of the SEC action and settlement, loss of Tesla customer confidence and future compliance expenses.

Musk, the suit said, is "no stranger" to false and outrageous public comments. In a purported April Fool's tweet joking that Tesla had gone bankrupt, he posted a picture of himself with a caption declaring that he was found "passed out against a Tesla Model 3, surrounded by 'Teslaquilla' bottles, the tracks of dried tears still visible on his cheeks."

Other signs of trouble cited in the suit included published accounts of board concern about Musk's workload and use of the sleep medication Ambien, a recent 2 ½-hour appearance on a Joe Rogan podcast during which Musk smoked marijuana, and wry and critical tweets by the CEO following the SEC settlement.

At least five of the company's other eight directors have conflict-producing ties or relationships to Musk, the suit said, and the other three receive substantial income from service on the board, averaging more than $1.5 million but ranging far higher.

"Even once these two new independent directors are appointed, the board will still lack a majority of independent and disinterested directors," the suit said.

Board members breached their duty to the company, among other ways, by failing to act on or disclose serious problems associated with Musk's conduct, the suit said.

The unjust enrichment count seeks disgorgement of director "profits, benefits and other compensation."

According to the SEC, Musk said he calculated the $420-per-share price for the fictitious go-private deal based on an assumed "standard premium" of 20 percent in go-private transactions, plus $1. Musk picked the resulting $420 number, the SEC said, because "he had recently learned about the number's significance in marijuana culture and thought his girlfriend 'would find it funny, which admittedly is not a great reason to pick a price.'"

Representatives for Tesla were not immediately available for comment.

Zachary Elton and the proposed stockholder class are represented by Michael Van Gorder of Faruqi & Faruqi LLP.

Counsel information for Musk and the board was not immediately available.

The case is Zachary Elton, derivatively on behalf of nominal defendant Tesla Inc., case number 2018-0749, in the Court of Chancery of the State of Delaware.

--Additional reporting by Dean Seal. Editing by Aaron Pelc.