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Musk Tries a New Way Out of Twitter by Matt Levine, Aug 29, 2022

A month ago, Elon Musk's fight with Twitter Inc. was a merger dispute. Musk signed a merger agreement with Twitter in April, in which he agreed to buy Twitter for about \$44 billion. Then the stock market went down, and Musk decided that he didn't want to pay \$44 billion for Twitter anymore. And so, like lots of other regretful acquirers before him, he tried to find an excuse to get out of the deal. There is a standard set of ways to do this. The merger agreement is 73 pages long, full of representations and covenants and conditions. You read through the merger agreement, you find some places where you think Twitter has not lived up to its obligations or met its conditions, you send Twitter a letter saying that and terminating the deal, Twitter sues you, and you meet up in Delaware Chancery Court to argue over what the merger agreement requires.

This is in fact what Musk did. Frankly I did not think that he did a very good job of it. His main excuse is that the merger agreement contained a representation that no more than 5% of Twitter's monetizable daily active users are spam or bot accounts, but in fact vastly more than 5% are bots, so he can get out of the deal. No part of this excuse is true in any way: The merger agreement does not contain that representation, there is no evidence that it's wrong, and even if it existed and was wrong it would not be a reason to get out of the deal unless it caused a "material adverse effect" on Twitter's business, which seems unlikely. Nonetheless, this is how you play the game. Musk is trying to prove that the merger agreement does not require him to buy Twitter; Twitter is trying to prove that it does. Like most observers, I think that it clearly does, so this is an uphill fight for Musk, but you never know.

There is, however, another approach. Imagine that the merger agreement was not 73 pages; imagine it was only a single sentence. "Elon Musk will pay \$44 billion in cash on Oct. 31, to buy Twitter Inc., no matter what, with absolutely no conditions." Then I think everyone would agree that the merger agreement requires him to buy Twitter.

But then imagine that it turned out that Twitter was an entirely fake company: It had no revenue, sold no ads, made no money, had no users (except Elon Musk?); it was just a long-running fiction that a handful of Twitter executives used to trick shareholders into giving them money, and their plan to exit the scam was to sell the whole thing to Musk. Imagine the truth came out — perhaps there’s a whistle-blower — between signing and closing. Would Musk have to close the deal? According to the language of the contract, sure, yeah, “no matter what.” But the real answer is no. Musk could get out of the contract, not under the terms of the contract, but because Twitter got him to sign the contract via fraud. And he could go to court, claiming fraud and demanding “rescission” (tearing up the contract), and — in this imaginary scenario — the court would probably agree with him. Obviously that’s not what happened, but I suppose you could tell a story that something like that happened. The story would be: “Twitter goes around saying that fewer than 5% of its mDAUs are bots, but that is a lie, and Musk was deceived by that lie, so he signed the merger agreement, so he was defrauded and can get out of it, regardless of what the merger agreement says.” And in fact that is part of Musk’s defense (technically, his first counterclaim ¶) to Twitter’s lawsuit: Even if he has to close the merger under the terms of the merger agreement, that doesn’t matter, because he was tricked into signing the merger agreement by Twitter’s fraud.

I am not very impressed by this theory either. For one thing, it has no evidence that Twitter did any fraud at all; Musk’s complaints about the bots are completely made up. For another thing, proving fraud requires proving a certain state of mind on both sides. Twitter didn’t commit fraud unless it had some intent to deceive; an innocent good-faith error about bot-counting might be enough to breach the merger agreement (it isn’t) but you’d need to prove an intentional lie to prove fraud. And Musk can’t claim fraud unless he relied on the fraud; he has to demonstrate that he believed Twitter about the bots and that that’s part of the reason he signed the deal, which obviously isn’t true. In fact, before the deal, he went around complaining about how Twitter had too many bots and how he was going to clean it up, so it is silly for him to now claim that he only signed the deal because he was tricked into thinking there were no bots.

But, you know, you try a bit of everything, why not.

And then last week a Twitter whistle-blower appeared: Peiter “Mudge” Zatko, a former security executive at Twitter, went public claiming that Twitter was doing various bad security things in fraudulent ways, being cavalier with user data and violating agreements with the Federal Trade Commission and concealing information from its board of directors.

We talked about this last week, and I noted that Zatko confirms that Twitter is right and Musk is wrong about their central contractual dispute: Zatko agrees with Twitter’s estimates that fewer than 5% of its mDAUs are spam bots; he just thinks that Twitter should be doing a better job of fighting spam accounts that it doesn’t count as mDAUs.

But the broader point is that Zatko’s claims can help Musk, because he alleges intentional fraud at Twitter that Musk didn’t know about. The schematic form of Zatko’s complaint is (1) Twitter was doing very bad security practices, (2) those practices created potentially disastrous risks (of legal liability, of lost business, of regulatory fines, etc.) for Twitter, (3) Twitter was lying to the public about those risks, and (4) its executives were doing that intentionally in order to keep their jobs and bonuses. “Never mind the stuff about the bots,” Musk could argue; “I was tricked into buying this company that was just a crater of liability because they were lying about their security practices.”