TESLA’S ELON MUSK: A TWEET TO BURN THE SHORTS?  
PART A

Introduction

August 7, 2018

While driving himself to the airport, Tesla’s CEO Elon Musk wrote and circulated the following tweet to over 22 million followers: “Am considering taking Tesla private at $420. Funding secured.”

The tweet would have immediately piqued the U.S. Security and Exchange Commission’s (“SEC”) interest. Given that Tesla was headquartered in Palo Alto, California, the SEC’s San Francisco Office (led by Regional Director Jina Choi) would have been responsible for looking into it. After a decade and a half at the SEC, Choi had developed a knack for quickly identifying securities law violations. Just in 2018, she and her team of 130 direct reports brought enforcement actions against Theranos and its CEO Elizabeth Holmes for an “elaborate years-long fraud,” and Yahoo! for failing to disclose one of the world’s largest data breaches.

Two possibilities would have jumped out at Choi. Musk either: (1) misled public investors; or (2) secured approximately $70 billion in financing, thus positioning Tesla for the largest leveraged buy-out (“LBO”) in history. Unless Musk had secured financing at $420 per share, his tweet was a false statement, and Choi would begin to build a case against Musk for violating Section 10(b) and Rule 10b-5 of the securities laws. A classic example of a Section 10(b) and Rule 10b-5 violation involves a company “executive making false statements in order to drive up share price.” Choi would have also had to consider Musk’s motivations and the impact of the tweet on Tesla’s stock price.

This case was prepared by Tanya Smith, under the supervision of Professors Doriane Lambelet Coleman and Wayne Norman. We would like to thank Professor James Cox, Geoffrey Smith, Valerie Soon, and Dennis Wurst for their invaluable contributions.
Tesla: A Brief History

Founding and Mission

Tesla, an American car, energy, and technology company, was founded in 2003 by Martin Eberhard and Marc Tarpenning. According to the company’s website, Tesla aims to “accelerate the world’s transition towards sustainable energy” through innovative products such as the Model S. According to correspondent Drake Baer, the company was the first American start-up in the twenty-first century to break successfully into the car industry, long-dominated by names like Ford, Chrysler, and General Motors.

Soon after founding Tesla, Eberhard and Tarpenning began to raise funds. As they surveyed potential investors, they reached out to PayPal co-founder Elon Musk. On March 31st, 2004, Eberhard emailed Musk:

“We would love to talk to you about Tesla Motors, particularly if you might be interested in investing in the company. I believe that you have driven AC Propulsion’s tzero car. If so, you already know that a high-performance electric car can be made. We would like to convince you that we can do so profitably, creating a company with very high potential for growth, and at the same time breaking the compromise between driving performance and efficiency.”

Musk replied within hours:

“Sure. Friday this week or Friday next week would work.”

Shortly after the meeting, Musk said he “was in.” He went on to lead the company’s $7.5 million Series A round. He also became the company’s biggest investor and Chairman of the Board. In 2008, two years before taking the company public, Musk acquired the additional title of CEO.

Tesla’s Leader: Elon Musk

Over the next decade and a half, Musk became the “face of Tesla,” inspiring a “celebrity following” amongst shareholders, employees, the media, and the general public. According to employees, Musk deserves “an immense amount of respect—for his intelligence, for his work ethic, for his guts, and for the gravity of the missions he has undertaken.” CNBC’s Jim Cramer described Musk as “a weird mix of Thomas Edison, David Blaine, and the Punisher. He’s a showman, a visionary, and he’s ruthless.” Musk has also been also viewed as “irresponsible” (e.g. he smoked marijuana during an interview) and “single-minded” (e.g. he dealt with production issues by sleeping on the factory floor), as well as “erratic, unstable, reckless, and operatic.”

Production, Performance, and Financing

In terms of scale, Tesla is significantly smaller than its rivals. Production numbers show that Tesla made just 100,000 cars in 2017, while GM produced 10 million cars. Tesla has also been criticized for “over promising and under delivering.” For instance, Tesla projected delivering 60,000 Model 3s during the last quarter of 2017—instead, the company delivered only 1550. As Marco della Cava framed it, “Tesla wasn’t even able to hit the weekly target in three months.”
Despite production challenges, Tesla has outperformed traditional car companies in the stock market. Furthermore, by 2018 it had achieved an equity market capitalization of approximately $60 billion — at times surpassing that of GM and Ford.\(^1\) Nevertheless, as of the second quarter of 2018, the company had never turned an annual profit. The company is notorious for repeatedly missing its lofty production goals.\(^{xvi}\)

In an effort to meet these goals, Tesla took on more than $10 billion in debt between 2010 and 2018. See Exhibit 9. According to Cowen's Jeffrey Osborne, by 2018, “Tesla [had] a gun to [its] head dictated by the timing of the debt payments.”\(^{xvii}\) Analysts and investors (already skeptical after fifteen years of missed production targets) questioned Tesla’s ability to generate enough cash to sustain operations and meet debt obligations.\(^{xviii}\)

As a result of these concerns, more than $13 billion in Tesla shares were being “shorted” by August of 2018.\(^{xix}\) This helps to explain why the August 7th tweet (announcing both a new source of funding for Tesla and a means of shielding the company from public market pressures) created such a stir.

**Corporate Governance**

According to Tesla’s website, its board of directors (board) serves “as a prudent fiduciary for shareholders to oversee the management of the Company’s business.” Prominent academics and members of the business media disagree, describing the board as “negligent” and submissive.\(^{xx}\)

In early 2017, Tesla’s board was comprised of seven individuals:

1) Elon Musk;  
2) his brother Kimbal Musk;  
3) - 5) his “longtime friends” and “major” investors: Steve Jurvetson, Antonio Gracias,\(^2\) and Ira Erhenpreis;\(^3\)  
6) Brad Buss, the former CFO of SolarCity, a company run by two of Musk's cousins;\(^4\) and  
7) Robin Denholm, Tesla's first woman director, and the only director at the time whose independence was not widely questioned.\(^{xxi}\)

That year, a coalition of investors wrote Tesla a letter demanding a more active, independent board. As a result, two independent directors were added:

8) Linda Johnson Rice; and  
9) James Murdoch.\(^{xxii}\)

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\(^1\) Tesla has outperformed traditional car companies in the stock market. That is, its stock price has increased by a larger percentage than that of its competitors. For instance, between January 1st, 2014 and August 7th, 2018, Tesla handily outperformed competitors with a return of 109.2% to investors. During the same period, GM returned 23.3% to its shareholders, while Ford shares decreased by 15.6%. All calculations are inclusive of dividends.\(^2\)

\(^2\) Despite the close personal and financial ties between Musk and Gracias, Gracias served as the “lead independent” director at the time of the tweet.\(^3\)

\(^3\) As a sign of their friendship, “Ehrenpreis passed up an opportunity to take the first Model 3 Tesla produced,” instead giving it to Musk as a birthday present.\(^4\)

\(^4\) Interestingly enough, Musk served as the chairman of SolarCity’s board while Buss served as a member of Tesla’s board. Furthermore, Musk was SolarCity’s biggest investor.
See Exhibit 10 for comprehensive board member biographies.

In 2018, in addition to being Tesla’s CEO and Chairman of the Board, Musk was also Tesla’s largest individual shareholder. As of August 7th, 2018, Musk owned approximately 20% of Tesla’s stock.

The Tesla Shorts

Given Tesla’s high stock price, lack of profits, negative free cash flow, negative working capital, and impending debt payments, the company has attracted “the most buccaneering of shorts.”xxiii Short sellers (“shorts”) are investors who, in a sense, bet that a stock’s price will fall in the future. Short selling stock in large quantities may exert tremendous “downward pressure” on a company’s stock price. See Exhibit 7. Musk’s son, Griffin (thirteen-years-old at the time), was not entirely off base when he provided his explanation in November of 2017: The short sellers bet “that the stock goes down, and they get money [if it does]. But [if the stock price goes] up high, they lose an insane amount of money.”xxiv

Jim Chanos and David Einhorn,5 fund managers described as “well capitalized, experienced, and ruthless,” have shorted Tesla aggressively.xxiv Chanos has criticized Tesla for its “accelerating rate of executive departures,” “incineration” of cash, and use of non-industry-standard accounting practices (e.g. excluding R&D expenses, service costs, and warranty costs from gross margin calculations). Chanos has even accused Musk of “misleading investors.” In April 2018 he commented, “I think Elon Musk has crossed the Rubicon in terms of making statements to investors that he might rue later.”xxvi Then, on the day of the tweet, Chanos claimed that “the short position is the best thing the stock has going for it. ‘Musk v. the Shorts’ is a far better narrative than ‘Tesla v. Mercedes/Audi/Porsche.’”xxvii With their large short positions and public criticisms, the Tesla short sellers clearly had Musk’s attention.

In a November 2017 Rolling Stone interview, Musk said, “[The short sellers are] jerks who want us to die... They’re constantly trying to make up false rumors and amplify any negative rumors. It’s a really big incentive to lie and attack my integrity. It’s really awful.”xxviii Musk also unleashed a pointed series of tweet attacks at the short sellers between May and August of 2018.xxix See Exhibit 4 and Exhibit 7.

Post-Tweet Reactions

Overview

Immediately after Musk’s tweet there was a jump in trading volume and a rally in share price. On August 7th, Tesla’s stock price closed at $379.57, up over 6% from the price it was trading at immediately before the tweet, and up nearly 11% from the previous day’s closing price. S3’s Head of Predictive Analytics, Ihor Dusaniwsky, estimated that the tweet cost Tesla short sellers $1.3 billion.

The rally was unusually short-lived, however. Within two days, Tesla shares closed below the pre-tweet price of $356.78. It seems that the market doubted the veracity of Musk’s “funding secured” claim.

CNBC Reacts on August 7th

Within minutes of the tweet, and throughout the day, commentators from multiple shows on CNBC (a market-focused TV network popular with investors) reacted. Reporter Phil Lebeau noted that the tweet was “completely out of left field.” Anchor Dom Chu observed that Tesla shares were “jumping,” and on-air discussants considered the possibility that Musk’s verified Twitter account had been hacked. See Exhibit 8. Members of the Halftime Report show noted that the announcement could “create serious difficulties for Musk, the company, and its investors.” CNBC’s Josh Brown posed a rhetorical question, “Are you allowed to make that statement, “funding secured,” if it’s not?” He received an emphatic response from Jim Lebenthal, “Of course you’re not.” However, that evening, Mad Money host Jim Cramer rose to Musk’s defense, arguing, “Musk has every right to say that he has a potential $420 per share takeover bid lined up, provided that he doesn’t sell stock into the hype... the SEC doesn’t specifically say you can’t ponder what a company’s worth or whether the company might get a bid... Twitter’s absolutely... the place to disseminate this possibility.”

Musk’s Intentions

In a class action filed by Andrew Left on behalf of himself and others, Left (one of the shorts) alleged that Musk intentionally targeted short sellers with his tweet. Duke Law Professor James Cox, one of the leading securities law experts in the country, takes a more nuanced approach, contending that Musk’s antipathy toward the short sellers may have been just one of the factors motivating his “funding secured” tweet. Cox explained, “short sellers were savaging Tesla and at a delicate time; it had a few billion in convertible debt coming due... and not enough cash to meet the debt... and its stock price was well below the breakeven for conversion...” He went on to speculate:

6 Kim, Tae, and Leslie Picker. “Elon Musk’s Tweet about Going Private Costs Tesla Short Sellers $1.3 Billion.” CNBC, 8 Aug. 2018, www.cnbc.com/2018/08/07/elon-musks-tweet-about-going-private-costs-tesla-short-sellers-more-t.html. Note that while the $1.3 billion figure is neither accurate nor inclusive of actual or realized losses, it is a good estimate of the paper value lost overnight. Assuming there were 34.5 million shares held short on August 7th, 2018 and accounting for an increase in stock price of $37.58 (the pre-Tweet August 6th, 2018 closing price was $341.99, while the post-Tweet August 7th, 2018 closing price was $379.57), the short sellers would have suffered a paper loss of approximately $1.3 billion.
“It is well open to surmise that [Musk] could have been motivated to promote more conversions of the debt, was in disbelief (hubris) that his company was not as valuable as he thought it should be, and [was dealing with] an acute case of the Superman complex (another facet of hubris) in being able to fulfill his dream.” xxxvii

The SEC: A Brief History

The Securities and Exchange Commission is the regulatory body charged with enforcing the federal securities laws. When the stock market crashed in October of 1929, investor confidence in the public markets hit a low point. In the midst of the Great Depression, Congress (eager to restore the public’s faith in the capital markets), passed two laws: (1) The Securities Act of 1933 (“The ’33 Act”); and (2) The Securities Exchange Act of 1934 (“The ’34 Act”). The ’34 Act authorized the creation of the SEC. The SEC’s mission is three-fold: (1) protecting investors; (2) maintaining fair, orderly, and efficient markets; and (3) facilitating capital formation. The SEC is particularly concerned with protecting investors from unfavorable asymmetries of information and power in financial markets. xxxviii One of the key ways in which the SEC addresses information asymmetries is through its rulemaking authority. That is, the SEC issues rules that build upon the ’33 and ’34 Acts. xxxix

Potential Violations

Legal Experts React

Within a day of the tweet, prominent securities law professors began to issue commentary regarding potential violations of Section 10(b), the fraud provision of the ’34 Act.

John Coffee Jr., a professor at Columbia Law School, commented:

“[Funding secured is] a clear factual statement... if it’s not fully secure, that’s potentially a very material misrepresentation, and a very straightforward violation of Rule 10b-5’ of the securities law[s]—in short, securities fraud.”

According to John Coates, a professor at Harvard Law School:

“It is illegal for a director or officer of a public company to knowingly or recklessly make material misstatements about that company... [Musk’s] tweets seem cryptic at best, and it is hard to see how he has complied with his duty to not be misleadingly incomplete.” xl

Sections v. Rules

The federal securities laws enacted by Congress are referred to as “legal sections.” The SEC drafts administrative “rules” aimed at clarifying or building upon the securities laws. xli Rule numbers correspond to the section of law
they pertain to. For instance, Rule 10b-5 (promulgated in 1942) corresponds to Section 10(b) of the ’34 Act. A violation of Rule 10b-5 also constitutes a violation of Section 10(b).

**Section 10(b) of the ’34 Act**

Section 10(b) of the ’34 Act makes it unlawful to “use or employ, in connection with the purchase or sale of any security... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.”

**Rule 10b-5**

Rule 10b-5 provides specific guidance under Section 10(b), making it unlawful to “make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements not misleading.”

“Funding secured”

Although it is not a legal or financial term of art, according to former SEC Chairman Harvey Pitt, the term “funding secured” means that a company has the “right to call upon the arranged financing.” Or, to put it in the words of Martin Viecha, Tesla’s Head of Investor Relations, “funding secured... means there is a firm offer.” See Exhibit 1 for a timeline of actions taken by Tesla and its employees in the hours following the tweet.

Musk’s Attempts to Clarify “Funding secured”

Within three hours of his first tweet announcing that he had “funding secured,” Musk tweeted:

1) “My hope is *all* current investors remain with Tesla even if we're private. Would create special purpose fund enabling anyone to stay with Tesla.”

2) “Shareholders could either to [sic] sell at 420 or hold shares and go private.”

3) “Investor support is confirmed. Only reason why this is not certain is that it’s contingent on a shareholder vote.”

See Exhibit 3 for screenshots of these tweets, also included in the SEC’s complaint.

The Path Forward

By the end of the day on August 7th, Jina Choi would have had a lot to consider. To get to the bottom of concerns like those raised by Professors Coffee and Coates, she would have needed more information to figure out what was really going on with Musk, Tesla, and those from whom he claimed to have secured funding. Only then could the SEC determine whether that tweet constituted a violation of Section 10(b) and Rule 10b-5.
More specifically, Choi and her team would have wanted the following information:

1) details of Musk’s Twitter activity around August 7th, 2018;
2) reactions of Tesla’s executives and board members in the wake of the tweet;
3) the identity of Tesla’s potential funding source;
4) details of communications between Tesla’s potential funding source and the company (e.g. number and length of meetings);
5) whether the alleged funding source had agreed to pay $420 per share; and
6) whether Tesla had hired a law firm or an investment bank to assist in its potential going-private transaction.

In addition to following leads provided by Musk on Twitter and on Tesla’s blog, Choi would have had to decide which of the SEC’s three investigative options to pursue:

1) a nonpublic MUI (matter under inquiry) to determine whether an investigation was warranted;
2) an informal investigation (thus circumventing the MUI step); or
3) a formal investigation (giving the SEC the power to compel evidence by means of subpoena).

See Exhibit 5. While an MUI and an investigation were certainly options, there were reasons why Choi might have been hesitant to recommend that the Commission use its discretionary power and limited resources to go after a somewhat ambiguous tweet.

Within the SEC itself, there were competing interests and priorities. Choi’s supervisors at the Office of the Commissioner and the Division of Enforcement had been appointed in a deregulatory climate. Under the direction of Jay Clayton, the SEC had become increasingly selective about the types of cases it pursued, prioritizing those aimed at protecting retail investors. Given the massive short positions held by institutional investors like Chanos and Einhorn, it was hard to argue that taking action here would primarily help retail investors. See Exhibit 7. Furthermore, should the SEC really be encouraging or discouraging CEOs from communicating informally with investors? On the one hand, cracking down could have the unintended, chilling effect of slowing down the flow of information from the Executive Suite to investors. But on the other, declining to investigate high profile cases might be interpreted as a signal that the SEC was willing to tolerate brazen attempts to manipulate share prices.

August 7th, 2018 was going to be a long day and night in the SEC’s San Francisco Office.
Questions

1) Given what investors and market watchers knew about Tesla, Elon Musk, and Musk’s Twitter habits (see a selection of other tweets in Exhibit 3 and Exhibit 4), why do you think the “funding secured” tweet was greeted with a fair amount of skepticism?

2) If you were in Jina Choi’s shoes and read Musk’s tweet, along with his letter to employees (also published as a blog post on Tesla’s website: see Exhibit 2), would you have launched an MUI, an informal investigation, or a formal investigation? See Exhibit 5 for details on procedures. Why or why not?

3) To what extent should an SEC investigation and possible sanction be influenced by factors such as the following: (a) Tesla’s 40,000 employees; (b) Tesla’s self-proclaimed role as a leader in transforming the world through sustainable energy; (c) Musk’s popularity (e.g. 22 million Twitter followers); or (d) the views of prominent business and financial opinion makers and commentators? In other words, what roles, if any, should politics and public perceptions play when regulators like Choi are deciding how to proceed?

4) Were Choi and her team to discover that Musk did not in fact have “funding secured,” would his tweet necessarily be a violation of Section 10(b)/Rule 10b-5? Consider the examples in Exhibit 6. Would it make a difference if the tweet had not included a share price of $420? What if, instead, the tweet had not included the second sentence: “Funding secured”?

5) If you were an independent member of Tesla’s board, what principles would you urge your CEO to follow when he is deciding what and how to tweet about Tesla, given your and his fiduciary responsibilities? What should the board do if he were repeatedly to ignore or violate such principles?

6) The communications of short sellers are less regulated than the communications of corporate officers. First Amendment rights will generally protect short sellers when they express personal opinions or spread rumors about companies whose stocks they are shorting, even when such claims turn out to be false. Is this fair? Does it make equities markets more or less efficient? Would Congress or the SEC be justified in regulating the communications by investors of the stocks they are shorting? If so, what specifically should be prohibited? And if not, why not? Consider the debate over short selling in Exhibit 7.
Appendix

Exhibit 1

August 7th Timeline

- Earlier that morning: The Financial Times disclosed that Saudi Arabia’s sovereign wealth fund had amassed a 3-5% stake in Tesla.  
- 12:48 p.m.: Musk uses his cellphone to tweet, “Am considering taking Tesla private at $420. Funding secured.”  
- 1:00 p.m.: Tesla’s head of Investor Relations texts Musk’s chief of staff asking, “Was this text [sic] legit?”  
- 1:13 p.m.: A Tesla investor who is friends with Musk’s chief of staff texts the chief of staff, saying, “What’s Elon’s tweet about? Can’t make any sense of it. Would be incredibly disappointing for shareholders that have stuck it out for so long.”  
- 1:23 p.m.: Tesla’s CFO texts Musk, “Elon, am sure you have thought about a broader communication on your rationale and structure to employees and potential investors. Would it help if [Tesla’s head of communications], [Tesla’s General Counsel], and I draft a blog post or employee email for you?” “Yeah, that would be great,” Musk texts back. “Working on it. Will send you shortly,” the CFO replies.  
- 2:00 p.m.: Musk tweets, “My hope is *all* current investors remain with Tesla even if we’re private. Would create special purpose fund enabling anyone to stay with Tesla.”  
- 2:13 p.m.: Musk tweets, “Shareholders could either sell at 420 or hold shares and go private.”  
- 3:07 p.m.: Responding to a Twitter user’s concern about a “forced buyout” in a go-private transaction, Musk tweets, “Def. no forced sales. Hope all shareholders remain. Will be way smoother & less disruptive as a private company. Ends negative propaganda from shorts.”  
- 3:16 p.m.: Musk emails employees about his desire to take Tesla private and posts the letter on the company’s blog.  
- 3:36 p.m.: Musk tweets, “Investor support is confirmed. Only reason why this is not certain is that it’s contingent on a shareholder vote.”  
- 5:09 p.m.: Replying to an investment bank research analyst asking for clarification about the financing that has been “secured,” Tesla’s head of investor relations emails back, “I can only say that the first Tweet clearly stated that ‘financing is secured’. Yes, there is a firm offer.” Shortly after that, the head of investor relations replies to another research analyst, writing, “[A]part from what has been tweeted and what was written in a blog post, we can’t add anything else. I only wanted to stress that Elon’s first tweet, which mentioned ‘financing secured’ is correct.”  
- 7:20 p.m.: When another Wall Street analyst asks Tesla’s head of investor relations about whether “funding secured” means there is a “firm offer” in the form of a commitment letter or verbal agreement, the investor relations exec replies, “I actually don’t know, but I would assume that given we went full-on public with this, the offer is as firm as it gets.”

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Exhibit 2

Musk’s Blog Post and Letter to Employees on August 7th

**Taking Tesla Private**
August 7, 2018

*The following email was sent to Tesla employees today:*

Earlier today, I announced that I’m considering taking Tesla private at a price of $420/share. I wanted to let you know my rationale for this, and why I think this is the best path forward.

First, a final decision has not yet been made, but the reason for doing this is all about creating the environment for Tesla to operate best. As a public company, we are subject to wild swings in our stock price that can be a major distraction for everyone working at Tesla, all of whom are shareholders. Being public also subjects us to the quarterly earnings cycle that puts enormous pressure on Tesla to make decisions that may be right for a given quarter, but not necessarily right for the long-term. Finally, as the most shorted stock in the history of the stock market, being public means that there are large numbers of people who have the incentive to attack the company.

I fundamentally believe that we are at our best when everyone is focused on executing, when we can remain focused on our long-term mission, and when there are not perverse incentives for people to try to harm what we’re all trying to achieve...

I would like to structure this so that all shareholders have a choice. Either they can stay investors in a private Tesla or they can be bought out at $420 per share, which is a 20% premium over the stock price following our Q2 earnings call (which had already increased by 16%). My hope is for all shareholders to remain, but if they prefer to be bought out, then this would enable that to happen at a nice premium...

Finally, this has nothing to do with accumulating control for myself. I own about 20% of the company now, and I don’t envision that being substantially different after any deal is completed...

This proposal to go private would ultimately be finalized through a vote of our shareholders. If the process ends the way I expect it will, a private Tesla would ultimately be an enormous opportunity for all of us. Either way, the future is very bright and we’ll keep fighting to achieve our mission.

Thanks,
Elon

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Exhibit 3

Three of Musk's Subsequent August 7th Tweets

My hope is *all* current investors remain with Tesla even if we’re private. Would create special purpose fund enabling anyone to stay with Tesla. Already do this with Fidelity’s SpaceX investment.

2:00 PM - 7 Aug 2018

Am considering taking Tesla private at $420. Funding secured.

Shareholders could either to sell at 420 or hold shares & go private

2:13 PM - Aug 7, 2018

19.6K 3,622 people are talking about this

Investor support is confirmed. Only reason why this is not certain is that it’s contingent on a shareholder vote.
Exhibit 4

Musk’s Tweets Regarding Short Sellers

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Who likes short shorts?

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They have about three weeks before their short position explodes

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Oh and uh short burn of the century comin soon. Flamethrowers should arrive just in time.

Looks like sooner than expected. The sheer magnitude of short carnage will be unreal. If you’re short, I suggest tiptoeing quietly to the exit ...
Exhibit 5

SEC Enforcement Flowchart\(^{10}\)

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Exhibit 6

Examples of Rule 10b-5 Violations and Non-Violations

<table>
<thead>
<tr>
<th>10b-5: Violation Found</th>
</tr>
</thead>
<tbody>
<tr>
<td>• A broker lied to a client about a stock, fraudulently inducing a purchase or sale in order to generate a commission.(^{11})</td>
</tr>
<tr>
<td>• A company hid billions of dollars in debt from failed projects with “creative accounting” practices.(^{12}) The Court concluded that the former CEO’s statement that the company’s businesses were “uniquely strong franchises with sustainable high earnings power” was not immaterial puffery.(^{13})</td>
</tr>
<tr>
<td>• An investment banker shared confidential, material information with his brother-in-law. His brother-in-law proceeded to trade on the insider information.(^{14})</td>
</tr>
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<table>
<thead>
<tr>
<th>10b-5: No Violation Found</th>
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<tbody>
<tr>
<td>• A print shop employee, in the scope of his job, found out which companies were going to be the targets of tender offers at inflated prices. The employee would buy stock in the targets before the tender offer was announced, and would then sell stock at a profit. The Court held that there was no violation since the employee was neither an insider nor a fiduciary.(^{15})</td>
</tr>
<tr>
<td>• A company announced that its auction process was “going smoothly,” despite the fact that bidders were dropping out of the process and/or submitting only disappointing bids. The Court held that mere sales puffery was not actionable under 10b-5.(^{16})</td>
</tr>
<tr>
<td>• An analyst received a tip from a whistleblower exposing corporate fraud. The analyst informed the media of the insider information, and tipped-off investors sold shares of the company before the share price collapsed. The Court held that a disclosure of material, non-public information without receipt of a personal benefit, did not trigger a breach of fiduciary duty, and thus, was not actionable under 10b-5.(^{17})</td>
</tr>
</tbody>
</table>

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\(^{11}\) See e.g. 40 S.E.C. 907. In Re Cady, 1961.
\(^{17}\) See e.g. Kravitz, Robert N. “Room for Optimism: The Puffery Defense Under the Federal Securities Laws.”
Exhibit 7

Short Selling

Mechanics
In its purest form, short selling is a way for an investor to profit from the price of a stock falling. Mechanically, there are four steps to shorting a stock profitably: (1) borrow shares of a company from an existing owner (usually through a brokerage firm); (2) sell the borrowed shares at the current market price; (3) buy the shares back at a lower price; and (4) replace the borrowed shares. The short seller is then able to pocket the difference between the market price and the lower price (less any dividends paid in the interim, for which the short seller is responsible). 18

The Debate
In October of 2018, Musk tweeted: “short-sellers are value destroyers. Should definitely be illegal.” His sentiment is shared by many. On a basic level, “short sellers benefit when a company performs poorly, and rooting against a company’s success seems anathema to the American way.”19

When a stock is heavily shorted, its price may be driven down, “even [if] the firm appears perfectly healthy.”20 In sum, a large short interest, in and of itself, may harm shareholders by exerting downward pressure on a company’s stock price.21 Many, including Musk, believe that short selling disproportionately harms “small investors and retirement funds” (i.e. those who invest for longer term gains).22 Downward pressure on a company’s stock price is exacerbated when short sellers engage in an illegal strategy known as “short and distort.” To “short and distort” means to take a short position in a stock before engaging in a “smear campaign [against the company] to drive down” the company’s stock price. Shorts engaged in this strategy manipulate the market, cluttering the internet and news outlets with false warnings (e.g. “get out before it all comes crashing down”) and unsubstantiated legal claims. 23

In the fall of 2018, Warren Buffet embraced short selling, noting that “short sellers tend to sniff out wrongdoing and shady behavior.”24 Consider, for example, the effect short sellers had on uncovering “fraudulent behavior, misleading accounting practices, and other shenanigans” at Enron and Lehman Brothers. Furthermore, short selling creates more efficient markets. Without short selling, the market would be more susceptible to bubbles.25

23  “Short and Distort” discussion substantiated by: Picardo, Elvis. “Short Selling: Ethics And The Role Of Short Selling.”
25  See “Short Selling: 5 Reasons to Love This Wall Street Taboo.”
Exhibit 8

Price of Tesla’s Common Stock

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Exhibit 9

Tesla’s Debt Outstanding

Exhibit 10

Board of Directors

Information Regarding the Board and Director Nominees

The names of the members of Tesla’s Board and Tesla’s proposed director nominees, their respective ages, their positions with Tesla and other biographical information as of April 1, 2018, are set forth below. Except for Messrs. Elon Musk and Kimbal Musk who are brothers, there are no other family relationships among any of our directors or executive officers.

<table>
<thead>
<tr>
<th>Name</th>
<th>Age</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elon Musk</td>
<td>46</td>
<td>Chief Executive Officer and Chairman</td>
</tr>
<tr>
<td>Brad Buss (1)(2)(3)</td>
<td>54</td>
<td>Director</td>
</tr>
<tr>
<td>Robyn Denholm (1)(2)(3)</td>
<td>54</td>
<td>Director</td>
</tr>
<tr>
<td>Ira Ehrenpreis (2)(3)</td>
<td>49</td>
<td>Director</td>
</tr>
<tr>
<td>Antonio Gracias (1)(2)(3)(4)</td>
<td>47</td>
<td>Director</td>
</tr>
<tr>
<td>Stephen Jurvetson (5)</td>
<td>51</td>
<td>Director</td>
</tr>
<tr>
<td>James Murdoch</td>
<td>45</td>
<td>Director</td>
</tr>
<tr>
<td>Kimbal Musk</td>
<td>45</td>
<td>Director</td>
</tr>
<tr>
<td>Linda Johnson Rice</td>
<td>60</td>
<td>Director</td>
</tr>
</tbody>
</table>

(1) Member of Audit Committee.
(2) Member of Compensation Committee.
(3) Member of Nominating and Corporate Governance Committee.
(4) Lead Independent Director.
(5) Mr. Jurvetson has been on a leave of absence from the Board since November 2017.

*Elon Musk* has served as our Chief Executive Officer since October 2008 and as Chairman of our Board since April 2004. Mr. Musk has also served as Chief Executive Officer, Chief Technology Officer and Chairman of Space Exploration Technologies Corporation, a company which is developing and launching advanced rockets for satellite, and eventually human, transportation (“SpaceX”), since May 2002, and served as Chairman of the Board of SolarCity Corporation, a solar installation company (“SolarCity”), from July 2006 until its acquisition by us in November 2016. Mr. Musk is also a founder of The Boring Company, an infrastructure company, and Neuralink Corp, a company focused on developing brain-machine interfaces. Prior to SpaceX, Mr. Musk co-founded PayPal, an electronic payment system, which was acquired by eBay in October 2002, and Zip2 Corporation, a provider of Internet enterprise software and services, which was acquired by Compaq in March 1999. Mr. Musk holds a B.A. in physics from the University of Pennsylvania and a B.S. in business from the Wharton School of the University of Pennsylvania.

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**Brad Buss** has been a member of our Board since November 2009. From August 2014 until his retirement in February 2016, Mr. Buss served as the Chief Financial Officer of SolarCity. Prior to joining SolarCity, from August 2005 to June 2014, Mr. Buss was the Executive Vice President of Finance and Administration and Chief Financial Officer of Cypress Semiconductor Corporation, a semiconductor design and manufacturing company. Mr. Buss served as Vice President of Finance at Altera Corp., a semiconductor design and manufacturing company, from March 2000 to March 2001 and from October 2001 to August 2005. From March 2001 to October 2001, Mr. Buss served as the Chief Financial Officer of Zaffire, Inc., a developer and manufacturer of optical networking equipment. Mr. Buss also serves as a director of Advance Auto Parts, Inc. and Cavium, Inc., and also served as a director of CafePress Inc. from October 2007 until July 2016. Mr. Buss holds a B.A. in economics from McMaster University and an honors business administration degree, majoring in finance and accounting, from the University of Windsor.

**Robyn Denholm** has been a member of our Board since August 2014. Since January 2017, Ms. Denholm has been Chief Operations Officer of Telstra Corporation Limited, a telecommunications company. Prior to Telstra, from August 2007 to February 2016, Ms. Denholm was with Juniper Networks, Inc., a manufacturer of networking equipment, serving first as its Executive Vice President and Chief Financial Officer and then as its Executive Vice President and Chief Financial and Operations Officer. Prior to joining Juniper Networks, Ms. Denholm served in various executive roles at Sun Microsystems, Inc. from January 1996 to August 2007. Ms. Denholm also served at Toyota Motor Corporation Australia for seven years and at Arthur Andersen & Company for five years in various finance assignments. Ms. Denholm previously served as a director of ABB Ltd., an automation technology company, from 2016 to 2017 and of Echelon Corporation Inc. from 2008 to 2013. Ms. Denholm is a Fellow of the Institute of Chartered Accountants of Australia and holds a Bachelor’s degree in Economics from the University of Sydney and a Master’s degree in Commerce from the University of New South Wales.

**Ira Ehrenpreis** has been a member of our Board since May 2007. Mr. Ehrenpreis has been a venture capitalist since 1996 when he joined Technology Partners, where he is a partner and has led its Cleantech practice for several years as a managing member. Since 2015, Mr. Ehrenpreis has also been a managing partner of the venture capital firm of DBL Partners. In the venture capital community, he has served on the board of the National Venture Capital Association and currently serves as the President of the Western Association of Venture Capitalists and the Chairman of the VCNetwork, an organization comprising more than 1,000 venture capitalists. In the Cleantech sector, he has served on several industry boards, including the American Council on Renewable Energy and the Cleantech Venture Network (Past Chairman of Advisory Board), and was the Chairman of the Clean-Tech Investor Summit in 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012 and 2013. Mr. Ehrenpreis serves as Chairman of the World Energy Innovation Forum. Mr. Ehrenpreis holds a B.A. from the University of California, Los Angeles and a J.D. and M.B.A. from Stanford University.

**Antonio Gracias** has been a member of our Board since May 2007 and has served as our Lead Independent Director since September 2010. Since 2003, Mr. Gracias has been Chief Executive Officer of Valor Management Corp., a private equity firm. Mr. Gracias is a director of SpaceX, and was a director of SolarCity until its acquisition by us in November 2016. Mr. Gracias holds a joint B.S. and M.S. degree in international finance and economics from the Georgetown University School of Foreign Service and a J.D. from the University of Chicago Law School.
Stephen Jurvetson has been a member of our Board since June 2009. Mr. Jurvetson has been on a leave of absence from the Board since November 2017. Mr. Jurvetson was a Managing Director of Draper Fisher Jurvetson, a venture capital firm, from 1995 to 2017. Mr. Jurvetson is a director of SpaceX, from which he is also on a leave of absence. Mr. Jurvetson holds B.S. and M.S. degrees in electrical engineering from Stanford University and an M.B.A. from the Stanford Business School.

James Murdoch has been a member of our Board since July 2017. Mr. Murdoch has held a number of leadership roles at Twenty-First Century Fox, Inc. (“21CF”) over two decades, including as its CEO since 2015, its Co-Chief Operating Officer from 2014 to 2015, its Deputy Chief Operating Officer and Chairman and CEO, International from 2011 to 2014 and its Chairman and Chief Executive, Europe and Asia from 2007 to 2011. Previously, he served as the CEO of Sky plc from 2003 to 2007, and as the Chairman and CEO of STAR Group Limited, a subsidiary of 21CF, from 2000 to 2003. Mr. Murdoch also serves on the boards of 21CF, Sky plc, where he has served as Chairman since 2016, and New Corp, and formerly served on the boards of GlaxoSmithKline plc from 2009 to 2012 and of Sotheby’s from 2010 to 2012.

Kimbal Musk has been a member of our Board since April 2004. Mr. Musk is a co-founder of The Kitchen, a growing family of businesses with the goal of providing all Americans with access to real food, and has also served as its CEO since its founding in 2004. In 2010, Mr. Musk became the Executive Director of The Kitchen Community, a non-profit organization that creates learning gardens in schools across the United States. Mr. Musk also co-founded Square Roots, an urban farming incubator program, in 2016. Previously, Mr. Musk was a co-founder of Zip2 Corporation, a provider of enterprise software and services, which was acquired by Compaq in March 1999. From 2012 to 2015, Mr. Musk was a director of the Anschutz Health and Wellness Center, a facility at the University of Colorado School of Medicine providing research, education and wellness services with the goal of achieving healthier lifestyles. Mr. Musk is also a director of SpaceX and of Chipotle Mexican Grill, Inc., an international chain of Mexican-themed restaurants. Mr. Musk holds a B. Comm. in business from Queen’s University and is a graduate of The French Culinary Institute in New York City.

Linda Johnson Rice has been a member of our Board since July 2017. Ms. Rice is currently the Chairman and Chief Executive Officer of Johnson Publishing Company, which owns Fashion Fair Cosmetics as well as extensive published works, where she has served in one or both capacities continuously since 1988 after joining in 1980. Ms. Rice has also served as Chief Executive Officer of EBONY Media Operations, which publishes EBONY and Jet magazines, since March 2017, and is a director and Chairman Emeritus of EBONY Media Holdings, its parent company. Ms. Rice also serves on the boards of the Omnicom Group and GrubHub Inc. Ms. Rice is Trustee at the Art Institute of Chicago, President of the Chicago Public Library Board of Directors, Council Member of The Smithsonian’s National Museum of African American History and Culture, and board member of After School Matters and Northwestern Memorial Corporation. Ms. Rice holds a B.A. in Journalism from the University of Southern California’s Annenberg School of Communication and an M.B.A. from Northwestern University’s Kellogg School of Management.
Endnotes


xi  Dayen, David. “Elon Musk and America’s Toxic Cult of the CEO.”


xx  Jeffrey Sonnenfeld of the Yale School of Management described the Tesla board as “completely negligent... Enron while it was


xxxi  Information about these seven directors is substantiated by Ohnsman’s article, cited above.

xxi  Information about these seven directors is substantiated by Ohnsman’s article, cited above.


xxiii  Ohnsman, Alan. “Elon’s Enablers: Tesla’s Submissive Board May Be As Big A Risk As An Erratic CEO.”
Tesla’s Elon Musk: A Tweet to Burn the Shorts?

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xxv  DeBord, Matthew. "Elon Musk Didn’t Use to Care about Short Sellers - Here’s Why He Does Now."


xxix  https://twitter.com/elonmusk/status/992556974263947264.


xxxiv  The *Fast Money Halftime Report* show takes place from 12:00-1:00 P.M. EST and is known for being “fast-paced.” The following exchange, between Brown and Lebenthal, is sourced from note xxxiii.

xxxv  Guruds, Elizabeth. “Cramer’s 4 Reasons for Why Tesla’s Shorts Are Facing an Uphill Battle with Elon Musk.” Note that Jim Cramer’s argument appears to disregard conventional understandings of the fraud and disclosure provisions of the securities laws.


xxvii  Email sent from Professor James Cox to Tanya Smith sent on December 15th, 2018 at 10:21 A.M. EST.

xxviii  “As more and more first-time investors turn to the markets to help secure their futures, pay for homes, and send children to college, our investor protection mission is more compelling than ever.”

xxix  The information from this section is substantiated by the SEC’s website. SEC: *What We Do*, https://www.sec.gov/Article/whatwe.html.


