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Due Diligence and Disclosure – A Quagmire in Corporate Acquisition Contract: Case Reflection on Elon Musk-Twitter

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Abstract: Disclosure requirements in business contracts of mergers and acquisition remain somewhat nebulous with attendant post-contract quagmire and disputes between buyers and sellers. This paper aims to initiate a conceptual discussion on disclosure and diligence in acquisition contract with a slant on the Musk-Twitter acquisition and to propose a framework for achieving conflict-free acquisition. The paper draws insight from extant theorisation of disclosures in mergers, acquisitions, and risk sharing. Approach: The paper is conceptual and applies a critical discussion of current professional and scholarly literature toward a conceptual framework. Findings: based on the review of professional and scholarly papers, the paper finds apparent ambiguity regarding disclosure requirements during contract of acquisition. It also finds new clarity bourgeoning with newly decided business acquisition cases and new research regarding contestations that emerge after signing acquisition contracts. Furthermore, there is a paucity of a scholarly framework to proffer a guide to the seller and buyer toward reducing grey issues and attendant conflicts. Implications: the findings offer professional and academic implications regarding the need for caution, information, and advice in acquisition contracts. The paper is also significant for business schools as it provides a current teaching case on the dilemma in mergers and acquisition contracts. Furthermore, this paper initiates a new research agenda for further researchers to extend the discussion on acquisition contracts by top investors. Value: Using the most current case, the paper contributes to the field of merger and acquisition contracts by proposing a framework to reduce conflict and risks in corporate acquisition.

Keywords: Contract of acquisition; mergers; disclosure; due diligence

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1. Introduction

Mergers and acquisitions is a unique avenue for business combination and expansion. Given the ubiquitous and implicit complexities, Sherman (2011, p. xv) highlights that it is essential to have a solid understanding of the main drivers and inhibitors of every possible deal since merger and acquisition activity continues to expand at high rates and because entrepreneurs and venture capitalists are continuing to form new organizations and pursue new market opportunities (Sherman, 2011, p. xv). Therefore, understanding how to achieve price and valuation goals while ensuring that the transaction is effectively completed is crucial given the huge amount of money that is at stake in majority of the contracts (Sherman, 2011, p. xv). The recent acquisition contract of $44bn by Elon Musk to acquire Twitter is current example that modern day acquisition can consume a gargantuan amount and requires diligent protection from further post-contract legal costs arising from misunderstanding between the buyer and seller. However, given that business and concomitant contracts are fraught with some levels of obfuscation either advertently to outsmart another party or inadvertently, it becomes apposite to exercise due diligence and to seek information and to exhaust possible professional advice before committing. Experts also highlight that acquisition contract involves a relationship where trust and confidence exists and parties have a fiduciary and moral responsibility to eschew economic enticements that may becloud the envisaged confidence (Eisenberg, 2003, p. 1682).

As they entail the acquisition of a complete company, including all of its rights and responsibilities, merger and acquisition (M&A) deals are typically quite complicated. These transactions also have substantial financial worth (Aava, 2010, p. 31). Due to the complexity of the economic, financial, and legal issues involved in mergers and acquisition agreements, much specialist professionals are needed to negotiate these types of acquisitions (Aava, 2010, p. 31). Importantly, such financially huge acquisitions must involve the services of professionals who specialise in mergers and acquisition, such as lawyers, economists, accountants, and investment bankers. The amount of money involved, coupled with complex transactions and disclosure issues might delay the completion of acquisition deal even after signing; a case in point is the misunderstanding and delay that existed before the currently completed Elon Musk-Twitter purchase (Conger & Hirsch, 2022, p. 1). Accordingly, even when the parties have reached a definitive agreement on a number of issues, the enforcement of the transaction may be postponed. According to Aava (2010, p. 31) obtaining approval from the

competition authorities is a frequent cause of delays, but other legal concerns might also prevent the agreement from being performed as scheduled. The interval between signing and consummating the agreement may extend to one year (Aava, 2010, p. 31). Despite the apparent quandary that existed along the contract conclusion, Elon Musk offered not to continue with the imminent legal tussle and swiftly completed the contract of Twitter purchase at US$44B (Bloomberg (2022). This became a unique acquisition of modern time – regarding the value of acquisition and the buyer being the world's richest man as of the time of the acquisition. Hence, this paper provides a brief conceptual insight relating to contracts of acquisition with a view to contributing to the literature by highlighting the current Musk-Twitter acquisition.

1.1. Problem of Paper

Whilst acquisition is a celebrated mode of business expansion and capital growth, there are inherent risks and disappointments if disclosure and due diligence are inadequate in acquisitions. Although completed according to the initial contract price agreement, but the Elon Musk Twitter acquisition deal remains one of the case examples of how weak disclosure and due diligence may wreak havoc during a business acquisition. Accordingly, the problem of this paper is that given the apparent tussle, which emerged from the Twitter acquisition deal before its finalisation, there is yet a paucity of current research literature, which relates the Musk-Twitter acquisition within the theoretical ambit of mergers and acquisitions risks, which may emanate from a rift between disclosure and diligence. This paper seeks to bridge this gap in the literature and propose a framework.

1.2. Objective

Accordingly, this paper aims to initiate a conceptual and critical discussion on the Musk-Twitter acquisition and to highlight the disclosure and due diligence imperative in an expensive acquisition of this nature. It also aims to propose a framework for achieving an acquisition deal without conflict and with reduced risk.

2. Methodology

The paper is conceptual; it uses current professional and scholarly literature to develop a conceptual framework for reducing conflict and risk in future corporate acquisition contracts.

3. Disclosure and Risk Sharing During Merger and Acquisition

Marshall (2021, p. 1) opines that the seller's representations and warranties are one part of the purchase agreement that emphasizes the competing interests of the buyer and the seller in the sale of a business. In addition to fundamental economic terms, negotiating the terms of the purchase agreement also involves an exercise in the allocation of risk between both the buyer and the seller (Marshall, 2021, p. 1). The risks associated with mergers and acquisitions are not one-sided – it is not only the buyer that often gets exposed to risks; rather in some instances such as if the deal does not get to a tangible closure; the seller might also incur a substantial loss (Aava, 2010, p. 31).

In the views of Sherman (2011, p. xv), a merger or acquisition is a complicated transaction that is rife with potential issues and hazards. Many of these issues occur in the early stages and may result from many loopholes. Some of the loopholes may include inter alia a deal that is forced through which shouldn't be; mistakes, errors, or omissions caused by insufficient, hurried, or misleading due diligence; improper risk allocation during the bargaining of the factual paperwork; or because merging the companies after closing is now seen to be untidy. If a different means of resolving disputes is not discussed and agreed and is not incorporated in the definitive contracts, these dangers may result in expensive and drawn-out litigation (Sherman, 2011, p. xv). The case of Elon Musk-Twitter acquisition fall out before the final settlement is a typical case of a hurried deal, weak disclosure and weak due diligence, which narrowly escaped a legal tussle between Twitter and Elon Musk (Oxford Analytica, 2022, p. 1).

However, this quagmire should not have arisen if all necessary disclosure, due diligence and negotiations were given proper time and considerations. Given the apparent unavoidable risks during mergers and acquisition, Aava (2020, p. 31) proffers some recipe for a fair risk allocation between the buyer and the seller. The recipe has three variants namely the inclusion and/or usage of the following: 1. termination fees, 2. price adjustment mechanisms, and 3. Material Adverse Change (MAC) clauses. This representation, in the buyer's eyes, gives the buyer additional

assurance that there are no "gotchas" that the seller has not made known to it in writing. Buyers may argue that this representation is required in situations where they feel they haven't had enough time to do thorough due diligence, where the seller has pushed on a quick closure, or in which the buyer's due diligence has given them reason to be concerned. The knowledge criterion or the caveat for broad economic or industry conditions may be eliminated in more buyer-friendly variants of this picture (Marshall, 2021, p. 2). According to Marshall (2021, p. 2) sellers might see the suggested recipe as if the buyer is replacing comprehensive due diligence with onerous contract requirements. From the seller's point of view, this representation could lead to liability rather than liability for a breach of specifically negotiated representations and warranties if the buyer failed value the target acquisition properly. The seller should include as many qualifications as they can, and they should make sure that the representation extends beyond the acquisition agreement to any disclosure schedules or letters and, if at all possible, to any due diligence documents offered to the buyer (i.e., data room) (Marshall, 2021, p. 2)

The foregoing indicates growing scholarly and professional attention being paid to business contracts and particularly regarding disclosure. There are bourgeoning instances from experts in business and/or contract law, which suggest an inclination to transparent disclosure in business contractual agreements; thus, experts present arguments, which traverses *inter alia* trust, morality, efficiency, involuntary reliance, exclusive knowledge, etcetera.

As an instance, Fairbridges Wertheim Becker (2016, p. 2) opines as follows:

"While there is no general rule in our law of contract that all material facts must be disclosed and that non-disclosure automatically amounts to misrepresentation, there has been a steady progression towards a general test for deciding whether in a particular case silence amounts to a misrepresentation"(Fairbridges Wertheim Becker, 2016, p. 2)

They proceeded further to argue in favour of disclosure by summarising a related court judgement on business contract, wherein the concept of involuntary reliance was a key to a ruling. In their words, they summarised as below:

"The Court explained the test of involuntary reliance, stating that a party to a contract is expected to disclose certain information if such facts falls within his exclusive knowledge and as a result the other party involuntarily relies on him as the only source of the information" (Fairbridges Wertheim Becker, 2016, p. 2)

Whilst espousing some foundational principles that guide contract, the arguments contained in Eisenberg (2018, p. 595) seem to echo the sentiments summarised by Fairbridges Wertheim Becker (2016, p. 2). They argue that a responsibility reclines on the parties to disclose material facts, which in their knowing, the other party does not know. Hence according to (Eisenberg, 2018, p. 595):

"In a contractual context, disclosure of material facts that one party knows and knows or has reason to know the other party does not know should be required except in those classes of cases in which a requirement of disclosure would entail significant efficiency costs".

They further accentuate the argument, which favours disclosure by citing moral and efficiency validations as follows:

"This principle puts a thumb on the scale—in effect, creates a presumption—in favor of disclosure because of the moral and efficiency reasons that support disclosure. To overcome this presumption it is not enough that in a given class of cases a requirement of disclosure would entail some efficiency costs. Instead, the presumption is overcome only if disclosure would entail significant efficiency costs" (Eisenberg, 2018, p. 595).

Perhaps, the foregoing lends some credence to Brenkert (1998) central account of why and how trust plays an important role in business contracts. This suggests that parties to a contractual deal must not always wait for the court to remind the value and virtue implicit in embedding morality and trust in business contracts. Perhaps non-betrayal of trust and voluntary reliance would save time, resources, and money that are wasted in legal tussles that emanate from contract disclosure issues.

4. Seeking Fairness Opinion during Mergers and Acquisitions

Boards commonly look outside to check if the agreed price to be paid by the buyer or to be received by the seller is "fair from a financial point of view" to the corporate shareholders when assessing a merger or acquisition (M&A) transaction. They ask a financial advisor for a "fairness opinion" to enhance a better deal at the end of the contract. The assessment is typically provided by the investment banks advising on the merger, however other organizations with expertise in valuation may also be asked to do so (Davidoff, Makhija, & Narayanan, 2011, p. 483). Research indicates that a third party evaluation of the impartiality of a merger or acquisition is requested by 37% of acquirers and 80% of targets, respectively.

When employed by acquirers, these fairness views have an impact on deal outcomes, but not when used by targets. If the purchaser receives a fairness opinion, the transaction price is lower in deals, and it is more lowered if numerous advisors offer an opinion (Kisgen & Song, 2009, p. 179). The literature holds that acquisition of more information about the other party helps in reducing contract costs. If any of the market participants—management, boards of directors, or shareholders of the target or acquiring firms—have insufficient information about the firm's true market worth, the market for corporate control may fail due to asymmetric or inadequate information. This failure can be lessened if market players decide to buy more data about the worth of the target company. An "opinion on fairness" is a third party's assessment of this value (Bowers & Latham, 2004, p. 1). In the case of Musk-Twitter acquisition, it would seem that much of the needed information was not sought before reaching deal decision (Roumeliotis & Hals, 2022, p. 1).

5. Musk-Twitter Acquisition Fall Out – A Rift in Disclosure and Due Diligence

Just before the final settlement of the acquisition of Twitter by Elon Musk, the fall out between Twitter and Musk does suggest that at the end of the tunnel, disclosure may not successfully escape the contract without an expensive legal tussle; hence, it becomes cheaper and more virtuous for parties to engage each other understandably and amicably from the onset.

On April 25 2022, the Tesla CEO – Elon Musk made a $44bn offer to acquire Twitter (Stempel, 2022, p. 1), which the Twitter board accepted; however, thereafter after, Elon Musk requested to hold action pending some disclosure request regarding alleged Twitter spam accounts (Conger & Hirsch, 2022, p. 1). Accordingly, the Tesla CEO announced opting out of the deal if his requested disclosure on the alleged spam accounts are not met by Twitter, who in return threatened to take a legal action if Elon Musk backs out of the Twitter acquisition deal. Elon Musk, the founder and CEO of Tesla and the richest man in the world, announced on Friday 8 July that he was cancelling his $44 billion plan to acquire Twitter by asserting that Twitter had broken some of their merger agreement clauses. On their part, Twitter alleges that Musk was in a rush and seem to have downplayed due diligence before agreeing on the deal (Roumeliotis & Hals, 2022, p. 1). The counter accusations appeared to point to a rift between disclosure and

due diligence, which future parties need to be aware and to do everything possible to avoid.

The threat by Twitter was indeed carried out on 12 July when Twitter sued Elon Musk for backtracking on his $44 billion contract to purchase Twitter. The lawsuit request the USA Delaware court to mandate Elon Musk to complete the purchasing agreement at the agreed contract price of $54.20 for each Twitter share (Hals, 2022, p. 1). In return, Elon Musk files a countersuit on Friday 29 July which highlights breach of contract. In his analysis of the attendant legal battle, Roumeliotis (2022, p. 1) highlights that due to Musk's decision, Twitter and the billionaire Elon Musk are expected to engage in a protracted court battle. He forecasts the likelihood of the court action ending with re-negotiation. Roumeliotis further conjectures that in some instances, instead of a judge directing a transaction to be completed, contested mergers, and acquisitions that are brought before the US Delaware courts typically result in the corporations renegotiating agreements or the purchaser compensating the seller a settlement to withdraw. This is due to the fact that the target companies are frequently eager to end the ambiguity about their business future and to move forward (Roumeliotis, 2022, pp. 3-4).

To decide whether Musk can back out of the arrangement, Chancellor Kathaleen McCormick of the Delaware Court of Chancery set a five-day trial to begin on October 17. The dispute launched what was anticipated to become one of the largest legal tussles in the history of Wall Street, featuring one of the most spectacular businessmen in a case that could have culminated to a solemn contract lexis (Hals, 2022, p. 2). However, Musk completed the contract and purchased Twitter at the agreed price, and hence avoided the legal tussle.

6. A framework for Cushioning Conflicts and Risk in Corporate Acquisitions

Based on the foregoing, the author sieves some concepts that seems very vital for current and future parties to consider in the process of bidding for mergers and acquisition contracts. This is important in saving owners investments from being used in fighting post-agreement legal battles, which can be avoided with disclosure, due diligence, transparent risk reduction clauses, and seeking fairness opinion. These concepts are encapsulated in the proposed framework in figure 1.

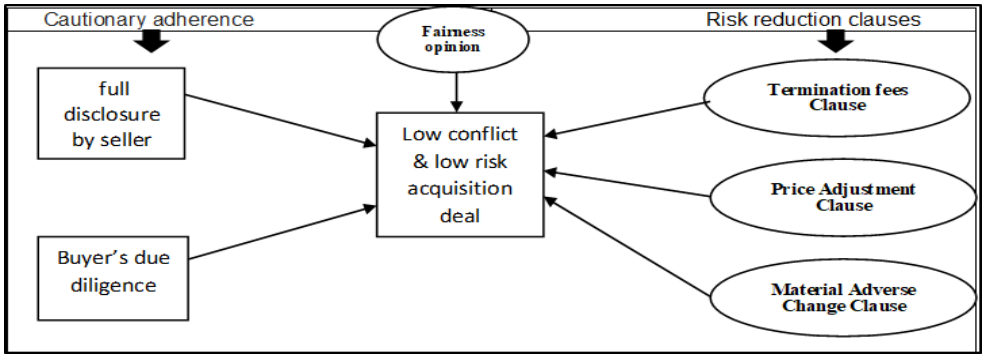

Figure 1. Conflict and Risk reduction Framework for Corporate Acquisition Contract

Source: Author's Proposed Framework

7. Implications

This paper has implication for professionals – including CEOs, the board of directors to visualise the rift implicit in disclosure and due diligence and the need for caution in subsequent contracts. The paper is also significant for business schools as it provides a current teaching case on the dilemma in mergers and acquisition contracts for lecturers and students. Furthermore, this paper initiates a new research agenda for further researchers to extend this discussion to widen our knowledge on acquisition contracts between top companies and top buyers.

8. Contribution (Value)

The paper makes the latest contribution to the field of merger and acquisition contracts by proposing a framework to reduce conflict and risk in corporate acquisition contract.

9. Conclusion

This brief paper highlights the danger that may surface if the parties in mergers and acquisition disagree on certain matters that they may consider material after heeding to the contract. Based on the review of professional and scholarly literature, the foregoing discussions finds the existing of apparent ambiguity regarding disclosure requirements during contract of acquisition (see example: Fairbridges Wertheim Becker, 2016, p. 2). It also finds that clarity keeps

bourgeoning with new decided cases and interests by researchers leading to new research literature findings regarding contestations that emerge after the contract is signed. Furthermore, there is a scarcity of a scholarly framework to proffer a guide to the seller and buyer toward reducing grey issues and attendant conflicts. This paper bridges existing gap in the literature and proposes a conceptual framework in Figure 1. The paper also notes that failure to avoid the hiccups in acquisition may result to enormous financial cost and time, which is spent in getting a settlement through the court. When this arises, the executives are not alone regarding the negative impacts; it also affects the shareholders of the company whom the executives owe the responsibility to protect their investments. However, it does seem that the aphorism "*the grass suffers when two elephants fight*" becomes applicable regarding the effect on shareholders. This is why some commentators express the view that the shareholders expect a fiduciary responsibility, which should protect them even under the contract and under this tussle between Musk and Twitter (Hals, 2022, p. 2). Scholars and practitioners need to realise that business is analogous to a warfare where opponents do their best to outwit each other – this was evident between Musk and Twitter. Whether there will be a winner, a loser, or no victor no vanquish – leading to amicable settlement will be decided by the court. The court decision will certainly. However, is important to note that Elon Musk's decision to continue with the acquisition (before the legal trial commenced) has yielded new lessons for future acquisition contracts – both for the investors and for scholars. This paper thus contributes to the scholarly and professional discussions around the Musk-Twitter tussle before and after Elon Musk offered to end the impending legal tussle and finalise the acquisition [The Guardian, 2022; Bloomberg, 2022; CTV, 2022]. The paper also proposes a framework for future business contracts to avert costly post-contract misunderstanding and legal battle.

This paper provides the most current teaching case insight on the quagmire in business acquisition contract to business schools, economics and law schools for lecturers and students. In addition the paper provides an agenda for further research to extend this initial thoughts when the Delaware Court or any other higher courts concludes decision on this high profile acquisition contract legal tussle.

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