

Nikola Founder's Fraud Conviction A Cautionary Tale

By **Linda Chiem**

Law360 (October 17, 2022, 8:43 PM EDT) -- Nikola Corp. founder Trevor Milton's criminal conviction on charges he misled investors about the electric-truck maker's business prospects is a cautionary tale for technology moguls who overpromise on solutions to the transportation industry's role as the largest contributor to air pollution in the U.S., experts say.

A Manhattan federal jury found Milton guilty of one count of securities fraud and two counts of wire fraud Friday after a monthlong trial that showcased how fine a line entrepreneurs must walk between what they promise and what they can actually deliver — lest they land in the crosshairs of the U.S. Department of Justice.

Milton was accused of pumping up Nikola's share price and defrauding retail investors by taking to television, podcasts and social media in the run-up to Nikola's 2020 debut on the Nasdaq and lying about how far along the company was in building zero-emission semi-trucks and its flagship Badger pickup. Phoenix-based Nikola went public in 2020 through a so-called reverse merger with a special purpose acquisition company called VectoIQ Acquisition Corp.

Within months, Nikola's share price tanked after a short-seller's report saying the company was an "intricate fraud built on dozens of lies," leading to Milton's ouster as executive chairman and investigations spearheaded by the Manhattan U.S. attorney's office and the U.S. Securities and Exchange Commission.

During the trial, government prosecutors painted Milton as a "con man" while Milton's attorneys argued that he was a staunch believer in his company's capabilities and that the government's case was a "grotesque distortion of the truth." Milton's lawyers hinted at an appeal after Friday's verdict.

The case boiled down to whether Milton, as the company's founder, was merely an aggressive salesman or whether his actions crossed the line into becoming fraud, experts say.

"Ultimately, the DOJ's case focused on fraud that occurred in plain sight, in the form of Mr. Milton's barrage of Twitter posts, podcasts and televised interviews," said Boies Schiller Flexner LLP partner David Simons, who specializes in complex litigation, corporate investigations and white collar criminal defense. "Although his defense lawyers tried to argue that Mr. Milton was simply overly enthusiastic about Nikola's technology, the jury determined otherwise when faced with a series of witnesses who testified that Mr. Milton's public statements were often false or misleading."

The prosecution also highlighted the dangers that companies face in not having robust checks and balances for decision makers or a well-defined compliance program, experts say.

"It should be a cautionary tale for companies, especially for startups that grow fast," Matthew Nielsen, a partner in Bracewell LLP's white collar practice, told Law360. "When companies see exponential growth in their operations, they're usually focused on dedicating resources to scaling up those revenue-generating operations. But the lessons learned here are that you also have to scale up your compliance program and your internal controls because as you grow fast, your risk profile changes rapidly."

Electric-vehicle makers have been riding a wave of momentum as technology developers, auto companies and policymakers focus more heavily on low- or zero-emission vehicles. But in their zeal to fast-track their grand plans to help combat the effects of climate change, executives still have to be prudent not to get ahead of the facts and their companies' engineering capabilities.

"When a startup experiences explosive growth, as Nikola did, its founders and early executives are often unprepared for the legal duties that govern companies soliciting investors, and particularly public companies," Simons of Boies Schiller said. "What in the early days may be a relatively harmless exaggeration or boast to some friends can snowball into a massive fraud on the investing public. Startups would be wise to adequately invest in a robust legal and compliance function in tandem with their growing valuations."

Milton's conviction offers another cautionary tale about the use of social media by corporate executives, according to Simons, who said Milton "joins the small but growing circle of high-profile executives who have paid the price civilly or criminally for statements made via social media."

During the trial, prosecutors offered evidence of text messages from Nikola employees who struggled to rein in Milton's brazen social media posts, with some lamenting that when Milton "has nothing to Tweet, he makes crap up," or that he "doesn't let facts or details get in the way of a good story" — countering the defense narrative that Milton was the victim of faithless employees and short-sellers seeking to cash in.

"By all reports, Mr. Milton was virtually in control of the company even after it became public, and he apparently resisted adding more independent members of the board and kind of hand-picked the key executive officers of the company," Bracewell's Nielsen said. "The allegations came out, which must've been a basis of the jury's findings, that he set this company up where not necessarily he had 'yes' men, but he didn't have the people in place with enough power to rein him in."

Statements being made by executives still have to be properly vetted by a team of professionals, including lawyers, accountants, product development specialists and investor relations experts to ensure that those statements are accurate and that the executives aren't "ad-libbing or speaking off the cuff," according to Morrison & Foerster LLP partner Edward Imperatore, a former assistant U.S. attorney in the Southern District of New York and leading member of its Securities and Commodities Fraud Task Force.

"And by the same token, it allows a transparent process for individuals to raise concerns about whether the information is accurate and up to date before it's made public," he said, noting that Milton's defense had argued that other Nikola employees had never flagged their concerns about Milton's statements to him in real time.

The case also cast a spotlight on SPACs, which had become a popular vehicle into public markets — with merger targets being lured by the promise of a public listing and fresh capital — but recently have begun to lose some of their luster. Often called blank-check companies, SPACs are shells that raise money in initial public offerings with the intent of acquiring and merging with a private company. The target assumes the SPAC's listing and goes public minus certain rigors associated with a traditional IPO.

"The case involved the application of a very traditional and straightforward theory of securities fraud to a new setting, and when I say that, I mean it took a very basic theory of securities and wire fraud — making misrepresentations to investors — and applied it to a de-SPAC transaction," Imperatore said, using the term for a reverse merger.

"The evidence in the case apparently showed that Milton chose a de-SPAC transaction because it allowed him to speak to investors during what would have been the quiet period for an initial public offering," he said. "Milton's basic defense was that he operated in good faith and that he believed in what he was telling investors, and he saw his statements as being aspirational and forward-looking. The jury, of course, rejected that."

Bracewell's Nielsen said that "one of the dangers that you have with that kind of [SPAC] transaction is that you take a private company and propel it into all the laws, rules and regulations that govern a public company in an expedited fashion."

"And so, when you have someone like Mr. Milton ... out there raising money for when the company is private and he's using what some may refer to as salesmanship puffery, then when you become a public company, that easily can become what people allege is fraud," he said. "[There's] a mentality that a lot of startups have, which is a kind of 'fake it until you make it,' but that doesn't work when you're a public company."

In December 2021, Nikola agreed to pay \$125 million to resolve separate SEC allegations that Milton falsely gave investors the impression that the company had reached certain product and technological milestones. But Nikola neither admitted nor denied the SEC's claims, and the company agreed to continue cooperating with the agency's ongoing litigation and investigation into Milton. The SEC's separate civil case against Milton has been paused until the criminal case wraps up.

Nikola said in a Monday statement that it appreciated the court's and jury's attention to the matter, and that it was important to note that the trial was related to statements that Milton had made several years ago.

"Neither the prosecutors nor Mr. Milton questioned the company's promising future and unique ability to positively transform the commercial transportation industry," the company said.

"With our vehicles in production and in the hands of customers, along with the energy infrastructure well on its way to support them, the company is making meaningful contributions toward cleaning up one of the world's most polluting industries," it added. "Nikola and its dedicated team continue to work relentlessly towards real long-term value for its shareholders as we work to create a cleaner and healthier planet for future generations."

--Additional reporting by Pete Brush and Tom Zanki. Editing by Jill Coffey and Alanna Weissman.

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