ELON MUSK AND THE VIRTUES OF RESTRAINT

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I. INTRODUCTION

Elon Musk doesn't much like the SEC. He has said publicly that he does "not respect the SEC"[1] and called them "bastards."[2] He once sent out a vulgar tweet stating that the SEC is a three-letter acronym, "middle word is Elon's."[3] He called the agency the "Shortseller Enrichment Commission."[4] He has repeatedly claimed that the SEC coerced him into a settlement with a metaphorical "'gun to [his] child's head'".[5] and argued that the agency is violating his constitutional rights.[6]

I imagine that the SEC doesn't much like Musk either. How could they? It's never fun to be criticized and vilified; Musk has repeatedly engaged in conduct that at best skirts the edges of the federal securities laws, if it doesn't outright violate them. Musk has thumbed his nose at settlements he previously agreed to and

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1. Jackie Wattles, *Elon Musk: 'I Do Not Respect the SEC'*, CNN BUS. (Dec. 10, 2018, 9:28 AM), https://www.cnn.com/2018/12/09/business/elon-musk-sec-twitter/index.html.

2. *See* Dave Michaels, *Elon Musk Rebukes Regulators Over 2018 Fraud Settlement*, WALL ST. J. (Apr. 14, 2022, 14:18), https://www.wsj.com/articles/elon-musk-rebukes-regulators-over-2018-fraud-settlement-11649965310.

3. *SEC Watchdog Says Two Elon Musk Tweets Violated Settlement Deal*, THE GUARDIAN (June 2, 2021, 2:58 PM), https://www.theguardian.com/technology/2021/jun/02/elon-musk-tweets-tesla-sec-settlement.

4. Matthew Goldstein & Randy Pennell, *Elon Musk Calls S.E.C. 'the Shortseller Enrichment Commission' on Twitter*, N.Y. TIMES (Oct. 4, 2018), https://www.nytimes.com/2018/10/04/business/elon-musk-sec-tweet.html.

5. *See* Hyunjoo Jin & Sheila Dang, *Musk Says U.S. SEC 'Bastards' Forced Settlement Over Tesla Tweets*, REUTERS (Apr. 14, 2022, 8:36 PM), https://www.reuters.com/technology/musk-says-us-sec-bastards-forced-settlement-over-tesla-tweets-2022-04-14/.

6. *See* Tom Krisher, *Elon Musk Accuses SEC of Unlawfully Muzzling Him*, NBC NEWS (Sept. 28, 2022, 9:35 AM), https://www.nbcnews.com/business/business-news/elon-musk-dispute-over-tweets-sec-funding-secured-agreement-rcna49769.

has continuously pushed the envelope testing the limits of those agreements.

But what should the SEC do about a problem like Musk, a man routinely described as "incorrigible"?[7] It's easy to think that the SEC should just throw the book at him. Sue him again and again or seek ever more severe sanctions for violating the settlements, including perhaps barring Musk from any further involvement with the companies he founded.

So far, the SEC has shown a certain amount of restraint in the face of Musk's provocations, although Musk clearly doesn't see it that way.[8] It can't be easy for the SEC and the agency has been widely criticized for not standing up to the world's richest man. There is a widespread impression that Musk has been treated leniently, that regulators have used kit gloves when harsher sanctions were available. As one columnist recently put it, the question is not "How does he get away with it?" but rather, "Why do the authorities let him get away with it?"[9]

But I would like to suggest that sometimes restraint is the better part of wisdom. There are times when the remedy can be worse than the disease. Too often, the SEC acts reflexively when it comes to enforcement and seeks to impose the maximum sanctions available without considering all the collateral consequences. They shouldn't, hard as that may be. SEC enforcement needs to be informed by the same principles that guide the SEC's overall

7. *See, e.g.*, Joel Rosenblatt, *Musk is 'Teflon Elon' Once Again as Jury Sides with Him Over 'Funding Secured' Tweet*, L.A. TIMES (Feb. 3, 2023, 5:22 PM), https://www.latimes.com/business/story/2023-02-03/jury-clears-musk-of-wrongdoing-related-to-2018-tesla-tweets ("Nobody does this – only Elon does this . . . He's incorrigible.") (internal quotes omitted); Izabella Kamiska, *The Joke's on Elon, Admits Elon*, FIN. TIMES (May 4, 2017), https://www.ft.com/content/71a50878-8595-3588-bf8e-99ad2c4f79fc ("In no time good old-fashioned incorrigible Musk was back. . . ."); *Chief Twit Elon Musk Must Regain His Wits*, FIN. REV. (Jan. 2, 2023, 11:51 AM), https://www.afr.com/companies/media-and-marketing/chief-twit-elon-musk-must-regain-his-wits-20230102-p5c9uq ("The incorrigible provocateur. . . ."); *Elon Musk, Génie Contrarié et Lessivé*, LE SOIR (Sept. 30, 2018, 18:16), https://www.lesoir.be/181460/article/2018-09-30/elon-musk-genie-contrarie-et-lessive ("À 47 Ans L'incorrigible 'Wonderboy'. . . .").

8. Indeed, Musk has repeatedly claimed that the agency is harassing him. *See, e.g.*, Dawn Kopecki & Michael Wayland, *Tesla CEO Musk Accuses SEC of Calculated Effort to "Chill" His Right to Free Speech*, CNBC (Feb. 17, 2022, 8:26 AM), https://www.cnbc.com/2022/02/17/tesla-ceo-musk-accuses-sec-of-calculated-effort-to-chill-his-right-to-free-speech.html.

9. Michael Hiltzik, *Why Don't Regulators Stop Elon Musk from Breaking the Law*, L.A. TIMES (May 18, 2022, 2:04 PM), https://www.latimes.com/business/story/2022-05-18/how-does-elon-musk-get-away-with-it.

mission: protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.[10] The SEC's enforcers have many tools at their disposal and need to take all of those guiding factors into account when deploying them. In the case of Musk, it may mean holding their noses a bit.

Musk's problems with the SEC began with a now infamous tweet in which he said: "Am considering taking Tesla private at $420. Funding Secured." That tweet was followed in short order by several others in which Musk made statements that seemed to indicate that the going private transaction was a done deal.[11]

The SEC sued Musk claiming these statements were false or misleading and alleging in particular that "Musk knew that he had never discussed a going-private transaction at $420 per share with any potential funding source."[12] The Complaint further alleged that "Musk's false and misleading public statements and omissions caused significant confusion and disruption in the market for Tesla's stock and resulting harm to investors."[13] Among other relief, the SEC sought to bar Musk from serving as an officer or director of Tesla.[14] The market reaction to the SEC filing was swift: Tesla shares fell 12% in after-hours trading, driven largely by concerns that Musk might be removed from his position running the company.[15]

Musk agreed to settle the charges a day later. The settlement was not exactly "lenient": Musk was enjoined from future violations of the antifraud provisions of the federal securities laws and ordered to pay a $20 million penalty (Tesla was separately ordered to pay another $20 million).[16] Musk also had to step down from serving as Tesla's Chairman for at least three years, and his communications, particularly his tweets, were subject to a form of

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10. *Mission*, SEC, https://www.sec.gov/about/mission (Aug. 29, 2023); *About the SEC*, SEC, https://www.sec.gov/about/ (Nov. 22, 2016).

11. Complaint at 1–2, SEC v. Elon Musk (S.D.N.Y. Sept. 27, 2018) (No. 18-cv-8865).

12. *Id.*

13. *Id.* at 2.

14. *Id.* at 22.

15. Jonathan Stempel & Alexandria Sage, *U.S. Regulator Sues Musk for Fraud, Seeks to Remove Him from Tesla*, REUTERS (Sept. 27, 2018, 4:15 PM), https://www.reuters.com/article/us-tesla-musk-sec/u-s-regulator-sues-musk-for-fraud-seeks-to-remove-him-from-tesla-idUSKCN1M72OI.

16. Final Judgment at 2, SEC v. Elon Musk (S.D.N.Y. Oct. 16, 2018) (No. 18-cv-8865); Press Release, SEC, Elon Musk SEC Fraud Charges; Tesla Charged With and Resolves Securities Law Charge (Sept. 19, 2018), https://www.sec.gov/news/press-release/2018-226.

pre-clearance.[17] But importantly, Musk was allowed to stay on as a member of the Board and as Chief Executive Officer, which started the chorus of critics claiming that the SEC had gone soft and was overly deferential to a powerful executive.[18]

Musk, of course, didn't see it that way at all. He later claimed that he was coerced into settling with the SEC because Tesla's lenders threatened to cease providing capital, which would have led to Tesla's bankruptcy.[19] And it appears that bankruptcy was a real possibility, which undoubtedly provided the agency considerable leverage in negotiations.

So, which one was it? Did the agency go soft and bend to the will of a rich and powerful man, or did the SEC put the screws on Musk and back him into a corner? Should the agency be criticized for lax enforcement, or should they be commended for showing some restraint and backing off from the most extreme sanction they could have imposed, namely removing Musk from running the company? When all the facts are unraveled, it would appear that the agency could have acted a bit more judiciously in this matter, particularly when it came to the possibility of barring Musk from serving as an officer or director of any public company.

Simply put, Musk is an essential element to Tesla's success, and removing him from running the company would harm investors, not help them. This is not the first time that the SEC has confronted a situation where a wrongdoer has been so intimately tied to the success of their enterprise that remedial action could have potentially deleterious consequences for shareholders. Typically in those cases, the SEC has sought to fashion resolutions that take account of a "key participant['s]" role at a public company even when the wrongdoing has led to criminal prosecution.[20] In the case of Musk, the final resolution may have been appropriate, but the way the SEC reached the decision was questionable at best.

17. Final Judgment, *supra* note 16, at 4.

18. *See, e.g.*, Aarian Marshall, *Elon Musk's Settlement Could Have Gone So Much Worse*, WIRED (Sept. 29, 2018, 8:20 PM), https://www.wired.com/story/elon-musks-sec-settlement-could-have-gone-so-much-worse/.

19. *See* Jin & Dang, *supra* note 5.

20. Examples include the shoe designer Steve Madden and the decorating guru Martha Stewart. *See* Litigation Release No. 19794, SEC, Martha Stewart and Peter Bacanovic Agree to Settle SEC Insider Trading Charges (Aug. 7, 2006), https://www.sec.gov/litigation/litreleases/lr-19794; Litigation Release No. 17015, SEC, SEC v. Steve Madden, 00-CV-3632. (E.D.N.Y) (May 23, 2001), https://www.sec.gov/litigation/litreleases/lr-17015.

Following the initial settlement, Musk wasted no time violating its terms. In particular, Musk sent out tweets about Tesla without going through the required pre-approval process. The SEC has sought to enforce the terms of the settlement agreement, and Musk has responded by trying to tear it up. Musk's thumbing his nose at the SEC has led to further questions about whether "the SEC has sharp enough teeth to rein in powerful and wealthy executives."[21]

But what should the SEC do? Like him or not, Musk has been very successful at building his companies, and the SEC must take account of the unique role he plays there. As of this writing, Tesla's market capitalization was around $827 billion;[22] by comparison, General Motors market cap was about $42.5 billion.[23] That is a lot of investor wealth tied up in Tesla's success. To be clear, I am not suggesting that Musk should be treated differently because he is rich, or successful, or even because he has created investor wealth; quite the contrary. My only point is that whatever action the SEC takes with respect to Musk should be informed and guided by the SEC's core mission, namely protecting investors. And that means taking account of Musk's role at Tesla.

This is a brief essay about SEC enforcement and some of the issues that are encountered when a securities law violator is so intimately tied to the success of their company that sanctions might undermine rather than enhance the goal of investor protection. I begin by detailing what happened in the Musk "taking Tesla private" case, and how the SEC responded. I then outline the aftermath and the continuing repercussions to try to draw some larger conclusions about the SEC enforcement process and how it needs to be more closely aligned with the underlying mission of the agency.

21. David Gura, *Can the SEC Stand Up to the Richest Man on the Planet*, NPR (Jun. 4, 2022, 8:01 AM), https://www.npr.org/2022/06/04/1102327987/elon-musk-sec-tweets-lawsuit-power.

22. *See Tesla, Inc. (TSLA) Stock Price, News, Quote & History*, YAHOO FIN., https://finance.yahoo.com/quote/TSLA/ (last visited Oct. 8, 2023).

23. *See General Motors Company (GM) Stock Price, News, Quote & History*, YAHOO FIN., https://finance.yahoo.com/quote/GM/ (last visited June 2, 2023).

II. WHAT HAPPENED: TAKING TESLA PRIVATE AND "FUNDING SECURED"

Musk's legal problems over the "taking Tesla private" tweets centered on the content and veracity of the statements and market's reaction to them. The tweets initially caused a spike in the price of Tesla shares, but uncertainty over the transaction pushed the price back down, and it never came close to the strike price before Musk abandoned the deal.

A. The Initial Tweets

On August 7, 2018, Elon Musk sent out a series of tweets to his more than 22 million Twitter followers in which he stated that he was considering taking Tesla private, indicating in substance that a deal was in place and only required shareholder approval to be consummated.[24]

In the first tweet, sent at 12:48 pm, Musk stated:

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

Over the next three hours Musk sent out additional tweets in which he stated:

> "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"
>
> "Shareholders could either to [sic] sell at 420 or hold shares & go private"
>
> "Investor support is confirmed. Only reason why this is not certain is that it's contingent on a shareholder vote."[25]

At the time he sent the tweets, Musk had had a few meetings with representatives of the Saudi sovereign wealth fund who indicated an interest in making a large investment in Tesla.[26] Just about a week before the tweets were sent out, Musk had a brief in-person meeting with representatives of the sovereign fund during

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24. Complaint, *supra* note 11, at 1.

25. *Id.* at 1–2.

26. *See* Chris Isidore, *Elon Musk Says He Would No Longer Accept Saudi Investment*, CNN: BUS., (Nov. 2, 2018, 12:25 PM), https://www.cnn.com/2018/11/02/business/musk-saudi-investment/index.html.

which, according to Musk, the representatives stated that they had already made a significant investment in Tesla, wanted to make an even bigger investment, and indicated an interest in taking Tesla private.[27]

So, when he sent out the first tweet, Musk was certainly considering taking Tesla private. The problem was that there was no deal actually in place. Funding had not been "secured," at least not in any legal sense: no firm commitment was ever made; no documents were signed; there wasn't even what might be considered an agreement in principle. Apparently, there had not even been any discussion of key terms: Musk said that he came up with the 420 figure by simply adding a 20% premium to the stock's closing price on August 2nd, when Musk sent an email to Tesla's Board of Directors, CFO and General Counsel in which Musk outlined his reasons for wanting to take Tesla private.[28] A 20% premium would have yielded 419 and Musk rounded it up to 420 as a joke reference to April 20th, marijuana celebration day.[29] Musk said he thought his girlfriend "would find it funny, which admittedly is not a great reason to pick a price."[30]

Although he informed the Board of his desire to take Tesla private, Musk never made a formal proposal to the Board and never sought or obtained Board approval for the transaction.[31] In addition, there was no practical way for most smaller investors to remain invested in Tesla if it were to become a private company.

As a result, the tweets were either false or misleading in several respects. Funding was not "secured," at least not in a formal or legal sense, there was no practical way for most shareholders to hold onto their shares in a going-private transaction, and there were numerous contingencies beyond shareholder approval that would need to be satisfied for a deal to go forward.[32]

27. Complaint, *supra* note 11, at 5–7.
28. *Id.* at 7.
29. *Id.* at 7–8.
30. *Id.* at 8.
31. *Id.* at 7–8.
32. *Id.* at 2.

B. The Initial Market Reaction

As might be expected, the tweets announcing a going-private transaction at a significant premium caused a spike in the price of Tesla shares. From the time of the first tweet on August 7th to the close of trading that day, Tesla's stock price went up 6.42%, and the stock closed up 10.98% from the previous day.[33]

In the following weeks, the stock price did not hit the $420 mark, indicating considerable investor uncertainty over whether the transaction would be completed at that price.[34] Moreover, the price of Tesla stock had already trended up following a positive earnings announcement on August 1st, and while the price rose some 6% after the tweets, the stock was already up about 4.5% that day *before* the first tweet went out.

C. The Follow-Up

After the tweets went out, there was considerable speculation in the press and among analysts about whether the going-private transaction was really going to happen,[35] and there were several attempts to get clarification from Tesla's investor relations people. On August 13th, Musk published a post on Tesla's public blog stating "funding secured" tweet was simply meant to convey his impression that a deal with the sovereign wealth fund could be concluded, and he wanted to get the process moving.[36] Musk also disclosed in this post that he was still in discussions with the fund and other investors about taking Tesla private and that a proposal had not yet been presented to Tesla's Board or a Board committee.[37] By the close of trading on August 13th, the price of Tesla's stock had declined to pre-tweet trading levels.[38]

After the close of the markets on August 24th, Musk announced in a blog post on Tesla's official blog that he was no

33. *Id.* at 2, 20.

34. *Id.* at 2, 8, 15–16.

35. *See, e.g.*, John Rosevear, *Will Elon Musk Really Take Tesla Private – or Is This a Giant Bluff?* THE MOTLEY FOOL (Aug. 8, 2018, 2:25 PM), https://www.fool.com/investing/2018/08/08/will-elon-musk-really-take-tesla-private-or-is-thi.aspx; Tom Huddleston, *Elon Musk Says He Wants to Take Tesla Private at Over $70 Billion – Here's What That Means*, CNBC (Aug. 9, 2018, 10:44 AM), https://www.cnbc.com/2018/08/08/elon-musk-wants-to-take-tesla-private--heres-what-it-means.html.

36. Complaint, *supra* note 11, at 14–15.

37. *Id.* at 15.

38. *See infra* note 41.

longer planning to take Tesla private. Musk stated: "Given the feedback I've received, it's apparent that most of Tesla's existing shareholders believe we are better off as a public company."[39] Musk also noted impediments to going private, including limitations on the ability of some institutional shareholders to invest in private companies and no real mechanism for smaller investors to remain invested in Tesla if it were to go private. On the next trading day, August 27, 2018, Tesla stock closed at $319.27, down more than 15% from the closing price on August 7th, the date of the initial tweets.[40]

The following chart details the price of Tesla stock starting just before the earnings announcement on August 1, 2018, and going through August 31, 2018.[41]

Date	Open	High	Low	Close	Change		Volume
31 Aug 2018	301.9995	305.31	298.6005	301.6605	-0.49%	-1.4895	5,375,104
30 Aug 2018	302.2605	304.6005	297.72	303.15	-0.61%	-1.8600	7,216,706
29 Aug 2018	310.2705	311.85	303.69	305.01	-2.20%	-6.8505	7,447,392
28 Aug 2018	318.4095	318.8805	311.19	311.8605	-2.32%	-7.4100	7,649,091
27 Aug 2018	318	322.4355	308.8095	319.2705	-1.10%	-3.5490	13,079,288
24 Aug 2018	320.7	323.85	319.3995	322.8195	+0.85%	+2.7195	3,602,564
23 Aug 2018	319.14	327.3195	318.1005	320.1	-0.48%	-1.5405	5,147,286
22 Aug 2018	320.8695	323.88	314.67	321.6405	-0.08%	-0.2595	5,945,955
21 Aug 2018	310.6095	324.7905	309	321.9	+4.36%	+13.4595	13,172,230
20 Aug 2018	291.705	308.5005	288.1995	308.4405	+0.96%	+2.9400	17,402,335
17 Aug 2018	323.5005	326.7705	303.5295	305.5005	-8.93%	-29.9490	18,958,612
16 Aug 2018	339.9105	342.2805	333.8205	335.4495	-0.96%	-3.2400	6,064,033
15 Aug 2018	341.9055	344.49	332.1405	338.6895	-2.57%	-8.9505	9,101,258
14 Aug 2018	358.4505	359.2005	347.1	347.64	-2.46%	-8.7705	6,986,427
13 Aug 2018	361.1295	363.1905	349.02	356.4105	+0.26%	+0.9210	10,463,881
10 Aug 2018	354	360	346.0005	355.4895	+0.86%	+3.0390	11,552,044
9 Aug 2018	365.55	367.0095	345.7305	352.4505	-4.83%	-17.8890	17,183,811
8 Aug 2018	369.09	382.6395	367.1205	370.3395	-2.43%	-9.2310	24,571,163
7 Aug 2018	343.8405	387.4605	339.15	379.5705	+10.99%	+37.5810	30,875,768
6 Aug 2018	345.4605	354.9795	341.82	341.9895	-1.77%	-6.1800	8,564,331
3 Aug 2018	347.8095	355.0005	342.5295	348.1695	-0.39%	-1.3710	13,656,486
2 Aug 2018	328.44	349.9905	323.16	349.5405	+16.19%	+48.7005	23,214,962
1 Aug 2018	297.99	303	292.9995	300.84			10,129,430

III. THE SEC ENFORCEMENT ACTION

After the going-private transaction was abandoned, the SEC quickly filed an enforcement action against Musk seeking severe

39. Complaint, *supra* note 11, at 15–16.

40. *Id.* at 16.

41. *Historical Data: Tesla Inc (TSLA.US)*, STOOQ, https://stooq.com/q/d/?s=tsla.us&c=0&d1=20180801&d2=20180831&o=1111111&o_s=1&o_d=1&o_p=1&o_n=1&o_o=1&o_m=1&o_x=1 (last visited Aug. 26, 2023).

sanctions, including an officer and director bar, sending shock waves through the market.

A. The SEC Files a Complaint

On September 27, 2018, the SEC filed a complaint against Elon Musk charging violations of the core anti-fraud provision of the federal securities laws, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder. The Complaint alleged that Musk's tweets on August 7th were false and misleading and caused significant confusion and disruption in the market for Tesla's stock, resulting in harm to investors.[42]

Three things are worthy of note about the SEC enforcement action.

First, is the rapidity of the action. The SEC has often been criticized for moving too slowly when it comes to enforcing the federal securities laws. Investigations have been known to drag on for years before a resolution is reached.[43] But in this case, the SEC acted at lightning speed: the Complaint was filed just over seven weeks after the alleged misconduct and roughly one month after the going-private transaction was scrapped.[44] The SEC does sometimes move very fast: the agency frequently brings emergency actions when there is evidence of ongoing fraud and where there is need to obtain urgent relief including in particular asset freezes.[45] But there was nothing like that here: there was no allegation of any ongoing fraud, no claim that Tesla was dissipating assets. In the absence of any apparent exigent circumstances, the rapidity with which the agency proceeded is noteworthy.

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42. Complaint, *supra* note 11, at 1–2.

43. *See, e.g.*, Sarah N. Lynch & Aruna Viswanatha, *Former Stanford Exec Says in Limbo as SEC Case Drags*, REUTERS (July 22, 2012, 1:58 PM), https://www.reuters.com/article/uk-stanford-sec-young/former-stanford-exec-says-in-limbo-as-sec-case-drags-idUKBRE86L0GE20120722; *Frequently Asked Questions*, SEC WHISTLEBLOWER ADVOCATES, https://secwhistlebloweradvocate.com/sec-whistleblower-frequently-asked-questions/ (last visited Oct. 18, 2023) (explaining that SEC investigations typically take two to four years to complete).

44. *See* Dave Michaels et al., *SEC Sues Elon Musk for Fraud, Seeks Removal from Tesla*, WALL ST. J. (Sep. 27, 2018, 10:37 PM), https://www.wsj.com/articles/elon-musk-sued-by-the-sec-for-securities-fraud-1538079650 (noting how the SEC has been criticized for moving slowly in the past, and how they moved very quickly in this case)

45. *See, e.g.*, Rohan Goswami, *SEC Asks for Emergency Order to Freeze Binance US Assets Anywhere in the World*, CNBC (June 6, 2023, 4:41 PM), https://www.cnbc.com/2023/06/06/sec-asks-for-emergency-order-to-freeze-binance-us-assets-anywhere-in-the-world.html.

Second, the SEC filed this enforcement action as a litigated action. Most SEC actions are filed as settled actions. Typically, the agency files a complaint in federal district court accompanied by a proposed consent decree subject to judicial approval, or the agency initiates an administrative proceeding and simultaneously makes findings of fact and imposes sanctions.[46] These negotiated resolutions are standard practice at the agency and are pretty much routine in cases involving financial institutions, regulated persons, and large public companies and their executives. To be sure, there have been instances where prominent defendants have refused to settle and chosen to litigate (*e.g.,* Mark Cuban)[47] or where the agency has proceeded to litigate against a large financial institution that may have been dragging its feet in settlement discussions (*e.g.,* Goldman Sachs),[48] but those are exceptions to the general rule. Most of the time, these types of enforcement actions are settled at the time of filing, in part because defendants prefer it that way: they would rather have one bad press day than two, and an unsettled action can cause reputational harm and market uncertainty.[49]

In this case, there were multiple reports Musk walked away last minute from a deal set in place, about which more in what follows.[50] But the fact that the agency went ahead and filed the Complaint as a litigated action is significant, particularly given the

46. *See, e.g.*, SEC Administrative Proceeding File No. 3-20955, SEC Brings Settled Actions Charging Cherry-Picking and Compliance Failures, SEC (Aug. 10, 2022), https://www.sec.gov/enforce/ia-6086-s; Consent Order at 1–8, SEC v. Binance Holdings Ltd., 1:23-CV-01599-ABJ (D.D.C. June 17, 2023).

47. *See* Marc Steinberg, *The SEC v. Mark Cuban*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 11, 2019), https://corpgov.law.harvard.edu/2019/04/11/the-sec-v-mark-cuban ("This litigation was far from standard fare. Unlike the vast majority of SEC enforcement actions that are settled pursuant to the consent negotiation process whereby the respondent neither admits nor denies the Commission's allegations of misconduct, Cuban declined to settle and proceeded to trial.").

48. *See* Press Release, SEC, SEC Charges Goldman Sachs With Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages (Apr. 16, 2010), https://www.sec.gov/news/press/2010/2010-59.htm#:~:text=Washington%2C.

49. *See* Daniel M. Hawke, *Settling SEC Enforcement Actions*, ARNOLD & PORTER, https://www.arnoldporter.com/-/media/files/perspectives/publications/2019/07/settling-sec-enforcement-actions.pdf?rev=31472f7e9bb04e65a3a5da4192e26b23 (last visited Oct. 18, 2023).

50. Matthew Goldstein, *Elon Musk Steps Down as Chairman in Deal With S.E.C. Over Tweet About Tesla*, N.Y. TIMES (Sep. 29, 2018), https://www.nytimes.com/2018/09/29/business/tesla-musk-sec-settlement.html; Isobel Asher Hamilton, *Elon Musk Reportedly Blew Up Settlement with the SEC at the Eleventh Hour*, BUS. INSIDER (Sep. 28, 2018, 4:37 AM), https://www.businessinsider.com/elon-musk-blew-up-tesla-settlement-with-sec-last-week-2018-9.

rapidity with which the agency proceeded and the apparent lack of any exigent circumstances.

The third noteworthy aspect of the SEC's Complaint is the relief the SEC was seeking. In its Complaint the SEC sought several things:

(1) An injunction against future violations of the statutory provision that was allegedly violated (Section 10(b) and Rule 10b-5).[51] This is standard practice and unremarkable: the SEC almost always seeks injunctive relief and even though the standard for granting such relief is that the offense must be capable of repetition, courts routinely grant injunctions on the ground that if a defendant did something once, they might do it again.[52]

(2) The SEC sought civil penalties.[53] This too is utterly unremarkable: the SEC now routinely seeks civil penalties as part of the resolution of almost all matters. The SEC has for all intents and purposes become a fining agency, often without regard to whether fines serve a proper enforcement purpose.[54]

(3) The SEC sought disgorgement of "any ill-gotten gains received as a result of the violations alleged" in the Complaint.[55] Seeking disgorgement of ill-gotten gains has also long been standard fare in SEC enforcement actions. Even though the SEC did not originally have specific statutory authority to obtain disgorgement in civil actions, courts had long ordered the remedy as part of the court's general equitable powers.[56] However, a couple of relatively recent Supreme Court cases raised questions about the ability to impose disgorgement;[57] in response, Congress granted the agency specific statutory authority to obtain disgorgement[58] and seeking it is routine in SEC enforcement actions. What is unusual about this case is that the Complaint didn't allege

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51. Complaint, *supra* note 11, at 21.

52. David M. Weiss, *Reexamining the SEC's Use of Obey-the-Law Injunctions*, 7 U.C. DAVIS BUS. L.J. 6 (2006).

53. Complaint, *supra* note 11, at 22.

54. *See* Press Release, SEC, SEC Announces Enforcement Results for FY22 (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206.

55. Complaint, *supra* note 11, at 22.

56. *See* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 864 (2d Cir. 1968).

57. *See* Kokesh v. SEC, 581 U.S. 455, 457 (2017) (holding that disgorgement is a penalty for statute of limitations purposes); Liu v. SEC, 140 S. Ct. 1936 (2020) (upholding SEC disgorgement authority but limiting its scope).

58. *See* Securities Exchange Act of 1934 § 21(d)(3), 15 U.S.C. § 78(u).

that there *were* any ill-gotten gains. There is nothing in the Complaint that even suggests that Elon Musk benefitted in any way from the allegedly unlawful conduct. A benefit to the wrongdoer is not a legal requirement for the charges, of course, although it does present a certain weakness in the factual narrative that will be addressed further below. But you do need ill-gotten gains for the SEC to obtain disgorgement of them, and the lack of any allegation that there were ill-gotten gains makes seeking disgorgement somewhat bizarre.

(4) Finally, the SEC sought an order prohibiting Elon Musk "from acting as an officer or director" of any public company.[59] This was the big-ticket item: the SEC was seeking to remove Musk from running Tesla or even working there in any significant capacity. The SEC has long had the authority to bar someone from acting as an officer or director of a public company,[60] either permanently or for a specified period of time, but the sanction is not frequently imposed.[61] Complete lifetime bars are particularly rare.[62] Even Elizabeth Holmes, the former CEO of Theranos who recently began serving a more than 11-year prison sentence for fraudulent conduct,[63] was only barred from serving as an officer and director of a public company for a period of ten years![64]

The legal standard for obtaining an officer and director bar ("O&D bar") is a violation of Section 10(b) and a "demonstrate[ed] unfitness to serve as an officer or director" of a public company.[65] The sanction is one of the most severe that can be imposed on an individual in an SEC enforcement action because it is career-

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59. Complaint, *supra* note 11, at 22.

60. *See* Jon Carlson, *Securities Fraud, Officer and Director Bars, and the "Unfitness" Inquiry After Sarbanes-Oxley*, 14 FORDHAM J. CORP. & FIN. L. 679 (2009).

61. *See* Renee M. Jones, *Unfit for Duty: The Officer and Director Bar as a Penalty for Fraud*, 82 U. CIN. L. REV. 439, 441 (2018) (Despite longstanding power to seek and impose bars, "the SEC seldom pursues the bars against directors or senior executives of large firms.").

62. *See* Andrew Krok, *Elon Musk, Tesla, and the SEC: How We Got Here and What Happens Next*, CNET (Sept. 28, 2018), https://www.cnet.com/roadshow/news/elon-musk-sued-sec-tesla-false-misleading-statements/, ("A lifetime bar is very onerous . . . and has limited precedent. . . . We note that lifetime bans for executives are unusual.")

63. *See* Catherine Thorbecke, *Elizabeth Holmes Set to Report to Prison*, CNN (May 30, 2023, 7:07 PM), https://www.cnn.com/2023/05/30/tech/elizabeth-holmes-prison/index.html.

64. *See* Press Release, SEC, Theranos, CEO Holmes, and Former President Balwani Charged with Massive Fraud (Mar. 14, 2018), https://www.sec.gov/news/press-release/2018-41 (The Holmes case was filed the same year as the Musk case).

65. Securities Exchange Act of 1934 § 21(d)(2), 15 U.S.C. § 78(u).

ending.[66] In practice, O&D bars have usually been reserved for the most egregious cases and are often tied to underlying or related criminal misconduct.[67] Moreover, imposing this sanction is particularly problematic in a case involving someone like Elon Musk who is, or at least is viewed as, essential to the company's success or even survival. There have been other cases involving "key persons," such as those of Martha Stewart and Steve Madden; however, both had underlying criminal convictions, and in both cases the bars were limited or tailored to allow the defendants to keep running the creative side of their respective companies.[68] In Stewart's case, for example, there was a five-year bar from serving as a director of a public company and a five-year *limitation* from serving as an officer of a public company by prohibiting Stewart from participating in certain financial aspects of company management, but not the creative aspects.[69] Seeking a complete O&D bar against Musk was extremely aggressive.

66. R. Daniel O'Connor & Annmarie A. Tenn, *Officer and Director Bars in the Current Financial Crisis*, NACD-DIRS. MONTHLY, Feb. 2009, at 12 ("An officer and director bar is one of the most severe sanctions that an individual in an SEC fraud case can face. It causes an instant end to a public-company career, and even bars of short duration can have a life-long negative effect.").

67. Over the past few years there has been a slight uptick in the use of officer and director bars, and the SEC's Director of Enforcement recently called them a "critical tool" in the agency's enforcement efforts, hinting that the agency would be seeking them more frequently going forward. *See* Gurbir S. Grewal, Director, Div. of Enf't, Remarks at SEC Speaks 2021 (Oct. 13, 2021). Indeed, the SEC Division of Enforcement's Chief Counsel recently stated that the agency might use its general equitable powers under Exchange Act Section 21(d)(5) to seek officer and director bars even in cases not involving scienter-based violations. Such an approach is legally dubious, however, given the explicit requirements laid out in Exchange Act Section 21(d)(2). *See also* Jonathan H. Hecht & Emily S. Unger, *Beyond Penalties and Disgorgement – What to Expect from the SEC in 2023*, LAW.COM (Feb. 15, 2023, 1:48 PM), https://www.law.com/newyorklawjournal/2023/02/14/beyond-penalties-and-disgorgement-what-to-expect-from-the-sec-in-2023/.

68. Steve Madden was criminally convicted of securities fraud and served several years in jail. The SEC barred Madden from serving as an officer and director of a public company for a period of seven years. *See* Litigation Release No. 17014, SEC, SEC v. Steve Madden, 00-CV-3632 (E.D.N.Y) (May 23, 2001), https://www.sec.gov/litigation/litreleases/lr-17014. But he continued to serve as a "creative and design chief" to his company drawing a salary of $700,000 per year even while in prison! *See* Rob Walker, *Genius of Capitalism: Steve Madden*, SLATE (Apr. 10, 2002, 12:43 PM), https://slate.com/business/2002/04/genius-of-capitalism-steve-madden.html.

69. Litigation Release No. 19794, SEC, Martha Stewart and Peter Bacanovic Agree to Settle SEC Insider Trading Charges (Aug. 7, 2006), https://www.sec.gov/litigation/litreleases/lr-19794.

B. The Market Reaction

The market reaction to the SEC filing was swift and severe: the price of Tesla's stock dropped 13.9% the following day,[70] wiping out some $7 billion in market value.[71]

It is more than a bit ironic that the filing of an SEC complaint alleging that certain violative conduct "caused significant confusion and disruption in the market for Tesla's stock resulting harm to investors"[72] had largely the same (or perhaps an even greater) effect, and for much the same reason. In each case, the market was reacting to the possibility, and assessing the probability, of the occurrence of a major event that would have a significant impact on the value of Tesla's stock. In the case of Elon Musk's tweets, the market was evaluating the probability of the occurrence of a taking private transaction at a roughly 20% premium over the then-prevailing price. In the case of the SEC Complaint, the market was evaluating the probability that Elon Musk would be barred from serving as an officer or director of Tesla.

It is worth noting once again that while the market certainly reacted to Musk's tweets, the price rose 6.49%, then stabilized and fell back, and never came near to closing the spread with the anticipated $420 going-private price, reflecting considerable market skepticism that the transaction would actually go through.[73] Indeed, it may have reflected the fact that Musk's tweets did not mislead the market: if the market had believed the deal was finalized, pending nothing except shareholder approval, the price would have jumped to very near the $420 that Musk had purportedly offered.

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70. Claudia Assis, *Elon Musk 'Rolling the Dice' and Buying Time by Turning Down SEC Settlement*, MARKETWATCH (Sept. 28, 2018, 4:52 PM), https://www.marketwatch.com/story/elon-musk-rolling-the-dice-and-buying-time-by-turning-down-sec-settlement-2018-09-28.

71. *Tesla, CEO Elon Musk Settle SEC Fraud Case for $40 Million*, CBC (Sept. 28, 2018, 5:50 PM), https://www.cbc.ca/news/business/elon-musk-settlement-securities-fraud-charges-tesla-1.4844353.

72. Complaint, *supra* note 11, at 2.

73. It is also worth emphasizing the limited scope of the harm the SEC alleged: although the Complaint alleged "significant confusion and disruption in the market for Tesla's stock resulting in harm to investors," when the SEC later set up a "fair fund" to distribute money to injured investors, the potential claimants were limited to those who purchased Tesla stock in open market transactions between 12:48 PM on August 7, 2018, and 4:00 PM on August 8, 2018.
See Tesla Fair Fund, *In the Matter of Elon Musk and Tesla, Inc.*, RUST CONSULTING, (May 20, 2022), https://secvteslafairfund.com/Home/portalid/0.

The market reaction to the SEC Complaint, on the other hand, reflected a greater fear that the negative event—the removal of Musk as an officer or director—could actually occur, spurring related concerns over what that might mean for the future of Tesla and the company's ability to survive. Musk was viewed as such a key element to the success of Tesla that there was immediate speculation that Tesla could actually end up going broke.[74] Indeed, Musk would later say that bankruptcy was a real possibility that drove him to settle the matter.[75] And regardless of how imminent the threat of bankruptcy really was, the SEC Complaint drove Musk to settle very quickly.

C. The SEC Settlement

1. The Bar

Musk signed a consent decree the day after the SEC filed its Complaint,[76] and the settlement was announced and filed with the court the following day.[77] Musk later said that he settled the case because Tesla's banks were threatening to withhold capital after the SEC filing: it "was like holding a gun to your child's head."[78]

The terms of the settlement, however, represented something of a victory for Musk, at least on the surface: he was ordered to step down from serving as Chairman of Tesla and to not accept reappointment for a period of three years.[79] This was not an insignificant punishment, but it was a far cry from a complete officer and director bar: Musk was allowed to remain on Tesla's

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74. Dave Michaels, *SEC Sues Elon Musk for Fraud, Seeks Removal From Tesla*, WALL ST. J. (Sept. 27, 2018, 10:37 AM), https://www.wsj.com/articles/elon-musk-sued-by-the-sec-for-securities-fraud-1538079650 (noting Tesla's need to raise more money and the difficulties of doing so without Musk at the helm: "Without Musk, Tesla is just an auto maker burning too much cash and holding too much debt. . . .").

75. *See* Jin & Dang, *supra* note 5 ("Musk said he felt forced to settle with the SEC because banks threatened to cease providing capital if he did not do so, which would have made Tesla bankrupt immediately.").

76. *See* Consent of Defendant Elon Musk at 6, SEC v. Elon Musk (S.D.N.Y. Oct. 16, 2018) (No. 18-cv-8865).

77. Consent Motion for Entry of Final Judgment, SEC v. Elon Musk (S.D.N.Y. Sept. 29, 2018) (No. 18-cv-8865); Press Release, SEC, Elon Musk SEC Fraud Charges; Tesla Charged With and Resolves Securities Law Charge (Sept. 29, 2018), https://www.sec.gov/news/press-release/2018-226.

78. *See* Jill Goldsmith, *Elon Musk Says Twitter Bid is About Democracy and Freedom, "I Don't Care About the Economics at All"*, DEADLINE (Apr. 14, 2022), https://deadline.com/2022/04/elon-musk-twitter-sec-mark-cuban-1235002703/.

79. Final Judgment, *supra* note 16, at 4–5.

board and to retain his position as CEO, which many took to be a win for him.[80]

There were other elements to the settlement: Musk was ordered to pay a $20 million civil penalty[81] (Tesla separately was ordered to pay another $20 million in penalties);[82] and Musk was required to pre-clear any future communications concerning Tesla with Tesla's counsel,[83] a provision immediately dubbed the "Twitter Sitter." But the O&D bar was the principal concern, and it immediately raises the question of who blinked and why, and whether the SEC acted judiciously in this matter.

As previously noted, multiple press reports claimed a settlement was in place before the filing of the SEC Complaint and that Musk had backed out of the deal at the last minute. We have no way of confirming whether that's true, or what the content of any such settlement was, but the published reports are consistent: the settlement that Musk allegedly walked away from included a two-year bar from serving as Chairman of Tesla's Board and a $10 million fine.[84]

If this is correct, then Musk backed down and ended up with a worse deal than originally offered. Which of course raises the question of whether the SEC was being reasonable in its demands and why the agency moved so quickly. Media reports stated that when Musk walked away from the deal, his lawyers asked the SEC for more time to convince Musk to accept the settlement offer, but the SEC rejected the request and proceeded to immediately file the Complaint.[85] And, of course, the Complaint sought a complete officer and director bar.

80. *See, e.g.*, Aarian Marshall, *Elon Musk's SEC Settlement Could Have Gone So Much Worse*, WIRED (Sept. 29, 2018), https://www.wired.com/story/elon-musks-sec-settlement-could-have-gone-so-much-worse/.

81. Consent Motion for Entry of Final Judgment at 1, SEC v. Elon Musk (S.D.NY. Sept. 29, 2018) (No. 18-cv-8865).

82. Press Release, SEC, Elon Musk SEC Fraud Charges; Tesla Charged With and Resolves Securities Law Charge (Sept. 29, 2018), https://www.sec.gov/news/press-release/2018-226.

83. Final Judgment, *supra* note 16, at 4–5.

84. *See, e.g.*, Matthew Goldstein, Elon Musk Steps Down as Chairman in Deal with SEC Over Tweet About Tesla, N.Y. TIMES (Sept. 29, 2018), https://www.nytimes.com/2018/09/29/business/tesla-musk-sec-settlement.html?smid=url-share; *Tesla, CEO Elon Musk Settle SEC Fraud Case for $40 Million*, *supra* note 71.

85. *See* Matthew Goldstein, *Elon Musk Steps Down as Chairman in Deal with SEC Over Tweet About Tesla*, N.Y. TIMES (Sept. 29, 2018), https://www.nytimes.com/2018/09/29/business/tesla-musk-sec-settlement.html?smid=url-share.

To be clear, it is certainly appropriate to seek more in litigation than one would accept in settlement; indeed, it is often a necessary incentive to settlement that the full extent of the possible sanctions be compromised in some way: compromise is what settlements are all about, and they are an appropriate reflection of litigation risk.[86] But if Musk backed out of a settlement involving a limited bar, and the SEC immediately filed a complaint seeking a complete bar, that does start to sound a tad coercive. After all, the SEC staff must have appreciated how the market would react to the possibility of Musk being barred from serving as an officer or director and that filing a complaint seeking a complete bar would back Musk into a corner.

That is what Musk later said about the settlement: that it was like having a gun to his child's head and that he was essentially coerced into a settlement because Tesla's lenders informed him that they were going to cut off funding to Tesla if he litigated with the SEC, which would have put Tesla into bankruptcy.[87]

It is also possible that the reports concerning a settlement agreement were incorrect and the SEC always insisted on a complete officer and director bar in settlement negotiations. If this is the case, the SEC might have blinked when it agreed to a lesser sanction after the case was filed, perhaps after realizing the damage its Complaint had caused. In announcing the settlement, the SEC Co-Director of Enforcement stated, "[t]he resolution is intended to prevent further market disruption and harm to Tesla's shareholders."[88] If the SEC backed down in the face of market turmoil, they should be commended for it: SEC enforcement should always be guided by the goal of investor protection, and if SEC enforcement causes problems, the SEC should not stand on ceremony. If backing down helps calm the markets, the SEC should back down. After all, putting Tesla in bankruptcy would not have helped anybody, and it would have obviously harmed Tesla shareholders.

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86. *See* SEC v. Citigroup Glob. Mkts., Inc., 752 F.3d 285, 295 (2d. Cir. 2014) ("Consent decrees are primarily about pragmatism.").

87. Jin & Dang, *supra* note 5. Given how successful Tesla has become, it is worth recalling that Tesla was in a very precarious position in 2018–19, and even before the SEC filing, there was considerable speculation that Tesla could end up in bankruptcy. *See, e.g.*, Grace Donnelly, *Why This Chief Investment Officer Thinks Tesla 'Is on the Verge of Bankruptcy'*, FORTUNE (Mar. 27, 2018), https://fortune.com/2018/03/27/tesla-bankruptcy/.

88. Press Release, *supra* note 82.

Of course, this does raise the larger issue of whether the SEC should have ever sought a complete officer and director bar in a case like this. The SEC should have been aware of the market harms that would be caused by even threatening to remove Musk from running Tesla and should have acted accordingly, particularly given there was absolutely no exigent reason for moving at such breakneck speed.

2. Other Aspects of the Settlement

There are a few other aspects of the settlement worthy of note. First, although the Complaint sought disgorgement of ill-gotten gains, there was no disgorgement in the settlement. The reason for this is obvious: there were no ill-gotten gains in this case, and the Complaint didn't even allege there were any, even though it sought them. Which again raises the question of whether the SEC was deliberately over-egging the pudding to raise the ante and compel a settlement.

Second, there is the amount of the penalties. Musk and Tesla were each ordered to pay $20 million in penalties. How did the SEC come up with these figures? The simple answer is that the agency made them up out of whole cloth; indeed, according to the reports, the proposed penalty for Musk was originally $10 million and was simply doubled when Musk refused to accept it.[89] The penalties actually imposed were not tied in any way, or at least in any disclosed way, to the degree of misconduct, or to investor harm. And they were only loosely tied to the statutory scheme. The statutory provisions allowing the SEC to impose penalties for violations of the federal securities laws are divided into three tiers, depending on the severity of the violation, and each tier has an upper cap. In federal court actions, penalties for third-tier violations (the highest tier) can be imposed in cases involving "fraud, deceit, [or] manipulation . . . or indirectly result[ing] in substantial losses or creat[ing] a significant risk of substantial losses to other persons."[90] The maximum penalty for a third-tier violation by a natural person is $100,000.[91] But the statute allows such a penalty to be imposed *per violation.* The SEC has long taken an expansive view of what constitutes a violation: every

89. *See* Goldstein, *supra* note 85.
90. Securities Exchange Act of 1934, 15 U.S.C. § 78u(d)(3)(B)(iii).
91. *Id.*

distribution of a misstatement can be counted separately.[92] For example, a single misstatement in a proxy statement sent to a million shareholders can be counted as a million violations. In practice, this renders the statutory cap meaningless: the SEC can impose whatever penalty it desires (subject, of course, to court approval).[93] In the case of Elon Musk, there were five tweets that the SEC alleged were deceptive; but because the tweets went out to millions of people, the SEC could set the penalty as high as it wanted.

Tesla separately paid a $20 million penalty and that one is even harder to tie to the statutory scheme. The maximum third-tier penalty for an entity is $500,000.[94] Tesla was not charged with fraud or deceit; the company was only charged with record-keeping violations, namely that they failed to maintain controls and procedures designed to ensure that information required to be disclosed in various reports was properly recorded and reported.[95] Even assuming this conduct could rise to the level of a third-tier violation (as a deliberate or reckless disregard of a regulatory requirement), it's hard to imagine that there were *forty* separate violations here.

Moreover, Tesla is a public company. When a public company is ordered to pay a penalty, the cost of that penalty is ultimately borne by the shareholders, most of whom had nothing at all to do with the misconduct.[96] It is true that in this case, the SEC established a "fair fund" to distribute the penalty money to injured investors; but the cost is nonetheless borne by the then current shareholders: at best a fair fund results in a circular process where

92. *See* Jonathan N. Eisenberg, *Calculating SEC Civil Money Penalties*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 24, 2016), https://corpgov.law.harvard.edu/2016/01/24/calculating-sec-civil-money-penalties/.

93. *See* David Rosenfeld, *Civil Penalties Against Public Companies in SEC Enforcement Actions: An Empirical Analysis*, 22 U. PENN. J. BUS. L. 135, 180–83 (2019).

94. Securities Exchange Act of 1934, 15 U.S.C. § 78u(d)(3)(B)(iii).

95. *See* Complaint, SEC v. Tesla (S.D.N.Y Sept. 29, 2018) (No. 1:18-cv-08947). The charges involved violations of Rule 13a-15 under the Securities Exchange Act of 1934 (17 C.F.R. § 240.13a-15).

96. *See* Rosenfeld, *supra* note 93, at 143–45. It is true that Musk is the largest single shareholder of Tesla, but at the time of the conduct at issue he owned just under 20% of the company. *See* Robert Ferris, *Elon Musk Just Bought Another $25 Million in Tesla Stock*, CNBC (June 13, 2018, 4:14 PM), https://www.cnbc.com/2018/06/13/elon-musk-just-bought-another-25-million-in-tesla-stock.html.

shareholders are paying penalties that are then returned to shareholders.[97]

Third, there are the charges themselves. The settlement included an injunction against further violations of Section 10(b) and Rule 10b-5, which is scienter-based fraud. Scienter is defined as a state of mind embracing an intent to deceive or defraud.[98] While the Supreme Court has not yet ruled on the issue, lower courts have held that recklessness satisfies the scienter standard, but most courts have held that it must be conduct that is so reckless that it approaches intentional misconduct.[99]

Because meeting the scienter standard is so difficult, and because the collateral consequences of an SEC Section 10(b) charge can be so onerous, the SEC will frequently settle cases involving misstatements at public companies with a charge of violations of Securities Act Sections 17(a)(2) & (3), which are negligence-based fraud charges.[100] This includes situations where individuals are charged and where the alleged misstatements are described as egregious. To give but one example, this past fiscal year the SEC brought charges against the Boeing Company and its former CEO Dennis A. Muilenburg, for making materially misleading public statements following crashes of Boeing airplanes in 2018 and 2019. The SEC Director of Enforcement stated in a press release: "Boeing and Muilenburg put profits over people by misleading investors about the safety of the 737 MAX all in an effort to rehabilitate

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97. *See* Cynthia A. Glassman, *SEC in Transition: What We've Done and What's Ahead*, SEC (June 15, 2005), https://www.sec.gov/news/speech/spch061505cag.htm ("I cannot justify imposing penalties indirectly on shareholders whose investments have already lost value as a result of the fraud. Our use of so-called Fair Funds . . . as a vehicle to return civil penalties to defrauded investors . . . leads to the anomalous result that we have shareholders paying corporate penalties that end up being returned to them through a Fair Fund . . . This gets a headline, but it makes no sense to me – it is form over substance.")

98. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

99. *See* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 48 (2011) (The Supreme Court has not yet decided whether recklessness suffices to fulfill the scienter requirement); Miss. Pub. Emps.' Ret. Sys. v. Bos. Sci. Corp., 649 F.3d 5, 20 (1st Cir. 2011) (recklessness means a "highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it." (quoting SEC v. Fife, 311 F.3d 1, 9–10 (1st Cir. 2002)); Nat'l Elevator Indus. Pension Fund v. VeriFone Holdings, Inc. (*In re* VeriFone Holdings, Inc. Sec. Litig.), 704 F.3d 694, 702 (9th Cir. 2012) (scienter requires at least a showing of "deliberate recklessness," which is close to actual intent); S. Cherry St., LLC v. Hennessee Grp. LLC, 573 F.3d 98, 109 (2d Cir. 2009) (recklessness is "[a]n egregious refusal to see the obvious, or to investigate the doubtful." (quoting Chill v. Gen. Elec. Co., 101 F.3d 263, 269 (2d Cir. 1996)).

100. *See* Rosenfeld, *supra* note 93, at 166–69.

Boeing's image following two tragic accidents that resulted in the loss of 346 lives and incalculable grief to so many families."[101] Boeing paid a $200 million penalty, and Muilenburg, who made the allegedly misleading statements, paid a $1 million penalty.[102] Both settled to charges that they violated Section 17(a)(2) & (3).[103] And Muilenburg (who was no longer CEO at the time of the enforcement action) was not barred from serving as an officer or director of a public company (a sanction that is not available in cases of negligence-based fraud).

Fourth, as part of the settlement, Musk was required to get pre-approval from Tesla's lawyers of any communications relating to Tesla or that might be deemed material to the company or its shareholders.[104] This highly unusual so-called "Twitter Sitter" provision has proved particularly problematic in practice and has led to considerable antagonism and litigation between Musk and the SEC.

D. The Market Reaction

The market reaction to the settlement was also dramatic: Tesla stock jumped 17% after the settlement was announced, reflecting market approval of a deal that allowed Musk to remain at the helm of Tesla.[105]

IV. THE AFTERMATH

Two things happened shortly after the settlement was announced: Musk felt that he had been unfairly coerced into accepting it, and the private class action litigants got into the act.

101. Press Release, SEC, Boeing to Pay $200 Million to Settle SEC Charge That it Misled Investors About the 737 Max (Sept. 22, 2022), https://www.sec.gov/news/press-release/2022-170.

102. *Id.*

103. *Id.*

104. *See* Consent of Defendant Elon Musk, *supra* note 76, at 3.

105. *See* Phil Serafino & Dana Hull, *Tesla Stock Skyrockets After Elon Musk Remains CEO in SEC Settlement*, TIME (Oct. 1, 2018, 10:16 AM), https://time.com/5411428/tesla-shares-sec-settlement-elon-musk/.

A. Musk Doesn't Like the Settlement and the SEC Doesn't Like Musk

Less than six months after the settlement, Musk was back on Twitter, and the SEC was back after Musk. In February 2019, Musk tweeted out that Tesla would produce 500,000 cars that year.[106] The tweet was not pre-cleared with Tesla's counsel. The SEC moved aggressively, seeking to hold Musk in contempt for violating the terms of the settlement.[107] The parties sparred over whether the tweet contained material information about Tesla, which would have made it subject to the settlement order. After the judge overseeing the matter expressed some skepticism, the SEC apparently backed down.[108]

But over the next few years the SEC and Musk have been almost continually at loggerheads. Musk has repeatedly tried to undo the settlement,[109] and particularly the "Twitter Sitter" arrangement, most recently by unsuccessfully pressing a First Amendment claim.[110] Musk has also vilified the agency, claiming he was coerced into the settlement, stating he has no respect for the SEC, calling the SEC "bastards" and worse.[111] For their part, the SEC seems intent on investigating any possible misdeeds by Musk,[112] much to Musk's consternation,[113] but has largely, and wisely, refrained from exercising the nuclear option.[114] This has

106. Elon Musk (@elonmusk), TWITTER (Feb. 19, 2019, 7:15 PM), https://twitter.com/elonmusk/status/1098013283372589056?lang=en.

107. Litigation Release No. 24413, SEC, SEC Asks Court for Order to Show Cause Why Elon Musk Should Not be Held in Contempt (Feb. 27, 2019), https://www.sec.gov/litigation/litreleases/lr-24413.

108. Chris Prentice & Michelle Price, *In a Faceoff with Elon Musk, The SEC Blinked*, REUTERS (May 24, 2022, 11:15 AM), https://www.reuters.com/markets/us/faceoff-with-elon-musk-sec-blinked-2022-05-24/.

109. Lora Kolodny, *Judge Knocks Down Elon Musk's Bid to End Consent Decree*, CNBC (Apr. 27, 2022, 6:42 PM), https://www.cnbc.com/2022/04/27/judge-knocks-down-elon-musks-bid-to-end-sec-consent-decree.html.

110. Jonathan Stempel, *Elon Musk Loses Bid to End SEC Muzzle Over Tweets*, REUTERS (May 15, 2023, 4:40 PM), https://www.reuters.com/legal/elon-musk-loses-bid-modify-throw-out-agreement-with-sec-over-tweets-2023-05-15/.

111. *See, e.g.*, Jin &Dang, *supra* note 5.

112. The SEC is currently investigating Musk for a variety of possible violations unconnected to the Tesla case, including in connection with Musk's acquisition of Twitter. *See Elon Musk Under Investigation by US Agency for $44bn Takeover of Twitter*, THE GUARDIAN (Oct. 5, 2023, 7:20 PM), https://www.theguardian.com/technology/2023/oct/05/elon-musk-investigation-securities-fraud-twitter-takeover.

113. *See, e.g.*, Kopecki &Wayland, *supra* note 8 (Musk's lawyers claim SEC is harassing him).

114. There are signs, however, that the SEC may be losing patience. Just recently, the SEC filed a subpoena enforcement action alleging that Musk failed to appear for subpoenaed

undoubtedly emboldened Musk,[115] but it hasn't proven successful legally: the consent decree, including the "Twitter Sitter" provision, remains in place.[116]

B. The Private Litigation

The SEC enforcement action against Musk was followed in short order by a private class action lawsuit alleging the same misconduct, principally that the "funding secured" tweet was false and misleading.[117] Class actions almost invariably follow SEC enforcement proceedings against public companies and their executives, particularly if the SEC charges involve scienter-based fraud, but the class action here was nonetheless notable for three reasons: first, the case actually went to trial; second, the judge granted the plaintiffs summary judgment on two key issues; and third, Musk prevailed and was found not liable.

Very few securities class actions ever go to trial. According to one study, over a twenty-five-year period only 0.4% of securities class actions went to trial.[118] The reason for this is simple: there is so much money at stake that securities class actions are typically "bet the company"-type lawsuits that companies can't afford to lose. In the Tesla/Musk case, the plaintiffs were seeking $12 billion. The result is that if plaintiffs survive a motion to dismiss, the cases almost invariably settle and, overall, roughly half of all securities class actions are dismissed at the motion to dismiss

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testimony in the Twitter takeover case. *See* Dave Michaels & Alexa Corse, *SEC Sues Elon Musk in San Francisco Federal Court to Enforce Subpoena*, WALL ST. J. (Oct. 5, 2023, 5:49 PM), https://www.wsj.com/tech/sec-sues-elon-musk-in-san-francisco-federal-court-to-enforce-subpoena-481d9468.

115. *See* Dave Michaels & Rebecca Elliott, *SEC Has Limited Options to Regulate Musk*, WALL ST. J. (June 2, 2021, 5:54 PM), https://www.wsj.com/articles/sec-is-running-out-of-options-to-rein-in-elon-musk-11622670845 ("Musk has been poking the bear because he knows he can get away with it.").

116. Rohan Goswami & Lora Kolodny, *Elon Musk Still Needs "Twitter Sitter" Judges Rule*, CNBC (May 15, 2023, 1:46 PM), https://www.cnbc.com/2023/05/15/elon-musk-still-needs-twitter-sitter-judge-rules.html.

117. Elon Musk (@elonmusk), TWITTER (Aug. 7, 2018, 12:48 PM), https://twitter.com/elonmusk/status/1026872652290379776?lang=en.

118. James K. Goldfarb et al., *Securities Class Actions: Data, Trends, and Insights*, DAVIS WRIGHT TREMAINE (Mar. 13, 2023), https://www.dwt.com/blogs/financial-services-law-advisor/2023/03/securities-class-actions-data-trends-2022.

stage and the other roughly half settle.[119] The Tesla/Musk class action is a rare exception.

Second, after denying the motion to dismiss, the judge granted the plaintiffs summary judgment on two important issues: the falsity of the statements and scienter.[120] Because so few securities class actions ever go to trial, there probably isn't a large enough data set to draw conclusions from, but my sense is that summary judgment on an issue like scienter is exceedingly rare in securities class actions,[121] for the simple reason that scienter goes to state of mind and there will almost always be disputed issues of material fact when it comes to state of mind.

And the decision to grant summary judgment on scienter in this case was highly questionable: the case ended up going to trial over the issue of materiality,[122] but that allowed for testimony over the same facts that go to scienter, and the testimony showed that there were plenty of disputed issues of material fact on that score.

Musk testified at length at the trial: nine hours over three days.[123] Musk insisted that he was contemplating taking Tesla private at $420 and that when he said "funding secured," he meant that he was confident that he could obtain funding to do a going-private transaction if he wanted to, either through the sovereign wealth fund, or with other investors, or even using some of his own money.[124] While acknowledging that the "funding secured" tweet

119. *Id.* ("Securities class actions rarely reach trial. From 1997 to 2022, 46 percent of core federal securities lawsuits settled, 43 percent were dismissed, 0.5 percent were remanded, 0.4 percent went to trial, and 10 percent are pending.").

120. *US Judge Determines Elon Musk's 2018 Tweets Were Inaccurate and Reckless*, THE GUARDIAN (May 11, 2022, 2:15 PM), https://www.theguardian.com/technology/2022/may/11/elon-musk-twitter-saudi-arabia.

121. *See, e.g.*, Jon Brodkin, *Musk on Trial for Funding Secured Tweet –Experts Predict He's Going to Lose*, ARSTECHNICA (Jan. 13, 2023, 12:57 PM), https://arstechnica.com/tech-policy/2023/01/musk-on-trial-for-funding-secured-tweet-experts-predict-hes-going-to-lose/ (University of Iowa law Professor Robert Miller "told Ars it is 'incredibly unusual' for a plaintiff 'to win on summary judgment on the falsity and recklessness of the statement.'").

122. A fact is considered material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision or if there is a substantial likelihood that disclosure of an omitted fact would have been viewed by a reasonable investor as having significantly altered the "total mix" of information made available. *See* TSC Indus. v. Northway, Inc. 426 U.S. 439, 449 (1976); *see also* Securities Act of 1933, 17 C.F.R. § 230.405.

123. Matt McFarland, *Elon Musk is Back on the Stand in Trial Over Controversial 'Funding Secured' Tweet*, CNN BUS. (Jan. 24, 2023, 4:02 PM), https://www.cnn.com/2023/01/24/business/elon-musk-funding-secured-trial-testimony/index.html.

124. He testified for example that he could sell SpaceX shares to fund a Tesla acquisition, just as he sold Tesla shares to fund his Twitter acquisition. *See* Lora Kolodny, *Elon Musk Testifies He Would Have Sold SpaceX Stock to Take Tesla Private in 2018*, CNBC (Jan. 23,

may have been a tad too succinct,[125] Musk testified that he believed at the time that he could obtain funding to do the transaction and still believed at the time of trial that he could have obtained such funding.[126]

And the jury believed him: they took less than two hours to return a verdict in Musk's favor![127] The issue before the jury was one of materiality rather than scienter—that issue having been decided by the judge—but the two issues melded together, and the same evidence that came in for materiality also went to scienter. In the end, the jury determined that whatever misstatements there may have been were immaterial, but in a way, they were also saying that whatever Musk did, he didn't act with an intent to deceive or defraud.

The jury's verdict came as a shock to many people,[128] but it shouldn't have, for two reasons, one general and one specific. The

2023, 6:23 PM), https://www.cnbc.com/2023/01/23/elon-musk-says-he-would-have-sold-spacex-stock-to-take-tesla-private.html.

125. Musk made the case that his tweets shouldn't be taken too seriously given the limitations of the medium (240 characters). *See, e.g.*, Tim Higgins, *For Elon Musk, Two Cases About His Tweets, and Two Victories*, WALL ST. J. (Feb. 4, 2023, 2:08 PM), https://www.wsj.com/articles/for-elon-musk-two-cases-about-his-tweets-and-two-victories-11675537682.

126. *See, e.g.*, Joel Rosenblatt, *Musk is 'Teflon Elon' Once Again as Jury Sides with Him Over 'Funding Secured' Tweet*, L.A. TIMES (Feb. 3, 2023, 5:22 PM), https://www.latimes.com/business/story/2023-02-03/jury-clears-musk-of-wrongdoing-related-to-2018-tesla-tweets (noting that Musk testified at trial that the funding secured tweet was absolutely truthful).

127. *See* Lora Kolodny & Rohan Goswami, *Jury Finds Musk, Tesla Not Liable in Securities Fraud Trial Following 'Funding Secured' Tweets*, CNBC (Feb. 3, 2023, 8:42 PM), https://www.cnbc.com/2023/02/03/musk-tesla-board-not-liable-in-funding-secured-suit.html.

128. In a fairly typical reaction, one prominent law professor called the outcome "astounding" adding "[the] outcome makes you wonder if [the US anti-securities fraud law] is up to the job in modern markets." *See* Jody Godoy & Hyunjoo Jin, *Tesla's Elon Musk Found Not Liable in Trial Over 2018 'Funding Secured' Tweet*, REUTERS (Feb. 4, 2023, 8:46 PM), https://www.reuters.com/legal/securities-fraud-trial-over-elon-musks-2018-tweets-draws-close-2023-02-03/. Before the trial, many experts had predicted that Musk would lose and lose badly. *See, e.g.*, Jon Brodkin, *Musk on Trial for "Funding Secured" Tweet–Experts Predict He's Going to Lose*, ARSTECHNICA (Jan. 13, 2023, 12:57 PM), https://arstechnica.com/tech-policy/2023/01/musk-on-trial-for-funding-secured-tweet-experts-predict-hes-going-to-lose/ (One expert stated: "Elon's going to lose, and he's going to lose for a significant amount. We're just talking about exactly how much."). Musk's victory seemed particularly surprising in light of the judge's grant of summary judgment on two key issues. *See, e.g.*, Kalley Huang & Peter Eavis, *Jury Rules for Elon Musk and Tesla in Investor Lawsuit Over Tweets*, N.Y. TIMES (Feb. 3, 2023), https://www.nytimes.com/2023/02/03/business/elon-musk-tesla-investor-trial.html (One expert noted "I thought he was crazy to try his chances at trial, given the stakes involved" and with the pretrial rulings "[y]ou're fighting with one hand behind your back in that situation."); Jon Brodkin, *How Musk Beat Tesla Fraud Lawsuit: Juror Says Case Relied Too Much on Tweets*, ARSTECHNICA (Feb. 6, 2023, 2:13 PM), https://arstechnica.com/tech-policy/2023/02/how-musk-beat-tesla-fraud-lawsuit-juror-says-

general reason is connected to the fact that so few securities class actions go to trial; a corollary to the fact that most securities class actions settle is that the only ones that do go to trial are the weakest cases for the plaintiffs. The result is that when securities class actions do go to trial, the defendants prevail at least as often as not.[129]

The specific reason dealt with the narrative that the plaintiffs presented, and particularly what was lacking from that narrative. As far as I can tell, the plaintiffs never provided a cogent rationale for *why* Musk did what the plaintiffs claimed he did. Assuming for the sake of argument the two things that the judge granted summary judgment on—that the "funding secured" statement was false and that Musk knew, or was reckless in not knowing that the statement was false—that still leaves a big question of *why*: why did Elon Musk knowingly or recklessly put out false information about taking Tesla private? The answer to that question, or more precisely the lack of an answer to that question, goes both to materiality (which was still at issue in the trial) and to scienter (which, legally at least, no longer was).

This was after all a fraud trial: the gravamen of the Complaint was that there was some kind of fraud at issue, not just a material misstatement made intentionally, but a material misstatement that was made with *an intent to deceive or defraud*. In most cases involving a fraudulent scheme we know exactly why the misstatement was made: to obtain money. Indeed, many antifraud statutes (although not Section 10(b) and Rule 10b-5) are worded as prohibitions on "obtaining money or property" by means of false or fraudulent statements.[130] That is typically the case in the most closely analogous situation to the one at hand, namely where someone attempts to manipulate the price of a security by knowingly putting out false information about a public company,

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case-relied-too-much-on-tweets/ (noting that one expert "wondered [] how the jury and the foreperson could have ruled for Musk in light of Judge Chen's pretrial ruling that his tweets were false and made recklessly").

129. According to one study from 1997 to 2021, less than 0.2% of securities class actions (excluding those involving mergers and acquisitions) were tried to a verdict; of the few cases that proceeded that far defendants have won half the time. *See* Rebecca Elliot & Meghan Bobrowsky, *Elon Musk Found Not Liable in Trial Over Tweets Proposing to Take Tesla Private*, WALL ST. J. (Feb. 3, 2023, 8:06 PM), https://www.wsj.com/articles/elon-musk-found-not-liable-in-trial-over-tweets-proposing-to-take-tesla-private-11675464951.

130. *See, e.g.*, 18 U.S.C. § 1348 (making it unlawful "to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any . . . security . . . "); *see also* 18 U.S.C. §§ 1341, 1343.

like a pump-and-dump scheme or a short-and-distort scheme.[131] In a pump-and-dump scheme, for example, someone owns shares in a public company, or purchases such shares, and then puts out false positive information about the company in order to pump up the price and then dumps those shares at the height reaping thousands or even millions of dollars in profits, while those who purchased shares in the run-up invariably end up losing money when the falsity of the news is disclosed and the price drops precipitously.[132] But there was nothing even remotely like that in this case. Obtaining a financial gain is not an element of a Section 10(b) action, but it does provide a powerful motive for engaging in the conduct at issue.[133]

There are of course other possible reasons why Musk may have wanted to manipulate the price of Tesla stock, but the plaintiffs never quite came up with one. The only rationale that was put forward by the plaintiffs was that Elon Musk was trying to punish short-sellers of Tesla stock. Musk certainly made a number of negative statements about short-sellers and his desire to get back at them. But he stood to gain nothing from punishing short-sellers. The court's answer to this, in its ruling on the motion to dismiss, is less than persuasive: "Even if Mr. Musk stood to gain no direct financial benefit from the false statement, he stood to gain satisfaction from watching the short-sellers lose on their investments, sellers against whom he allegedly harbored animosity."[134] Satisfaction is a thin reed for a fraud claim.

In the end, there was very little put forward by the plaintiffs to explain how these allegedly material misstatements were

131. *See* Rajeev Dhir, *Pump-and-Dump: Definition, How the Scheme is Illegal, and Types*, INVESTOPEDIA (Jan. 13, 2022), https://www.investopedia.com/terms/p/pumpanddump.asp; Rick Wayman, *Short and Distort: Bear Market Stock Manipulation*, INVESTOPEDIA (Feb. 17, 2022), https://www.investopedia.com/articles/analyst/030102.asp.

132. *See, e.g.*, Press Release, SEC, SEC Uncovers $194 Million Penny Stock Schemes that Spanned Three Continents (Apr. 18, 2022), https://www.sec.gov/news/press-release/2022-62.

133. While obtaining a gain is not an element of a Section 10(b) action, plaintiffs in a private class action (though not the government in a public enforcement action) must show an economic loss and loss causation. Jay B. Kasner & Mollie Melissa Kornreich, *Section 10(b) Litigation: The Current Landscape*, A.B.A: BUS. L. TODAY (Oct. 20, 2014), https://www.americanbar.org/groups/business_law/resources/business-law-today/2014-october/section-10-b-litigation-the-current-landscape/ (citing Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005)).

134. *See In re* Tesla, Inc. Sec. Litig., 477 F. Supp. 3d 903, 930 (N.D. Cal. 2020). The Judge also considered the quick settlement of the SEC lawsuit to be probative of scienter which, under the circumstances, is questionable.

intended to deceive or defraud anyone.[135] The plaintiffs (and the judge) in the private action (and indeed the government in the SEC action)[136] acted as though all that was necessary was to show that the statements were false, and made intentionally or recklessly, without ever closing the loop to establish the essential element in the definition of scienter: "a state of mind embracing an intent *to deceive, manipulate or defraud*."[137] To the extent that recklessness can be used to satisfy the intent requirement, it must not only be egregious recklessness, but recklessness that is tied in some way to some kind of fraudulent conduct.

In the absence of a cogent explanation as to *why* Musk would knowingly or recklessly put out false information about his company, it was easy enough for the jury to believe Musk's counter narrative: that he *was* considering taking Tesla private at $420, that when he said "funding secured" he simply meant that he was confident he could obtain funding for the deal, and that he put out the tweets because he felt something of an obligation to inform ordinary shareholders that he was contemplating the transaction. Musk testified he had "no ill motive," noting that his intent was to do the right thing for all shareholders.[138] In the absence of a *why*, it was easy enough for the jury to conclude that there was no *material* difference between "funding secured" meaning a deal to obtain funding *had* been reached and "funding secured" meaning a deal to obtain funding *could* be reached.[139] The jury foreperson

135. As one prominent expert pointed out, the plaintiffs' attorneys did a poor job in making the case that Musk intended to manipulate Tesla's stock price: "I felt like they never really made the case that Musk's intent in sending the tweet was to move the stock price. They never went down that path, which I find surprising." *See* Kari Paul & Erin McCormick, *Jury Sides with Elon Musk Over 2018 Tweets Claiming He Would Take Tesla Private*, THE GUARDIAN (Feb. 3, 2023, 5:45 PM), https://www.theguardian.com/technology/2023/feb/03/elon-musk-tesla-investors-lawsuit-twitter.

136. The SEC also pointed out Musk's animosity towards short-sellers, but the Complaint never ties this animosity to Musk's alleged scienter. *See In re* Tesla, Inc., 477 F. Supp. 3d at 928–29; SEC v. Musk, No. 18-cv-8865 (S.D.N.Y. Apr. 27, 2022), *aff'd*, No. 22-1291 (2d Cir. May 15, 2023); *see also* Complaint, *supra* note 11, at 5.

137. Michael J. Becker, SEC Administrative Proceeding No. 3-10520 (June 21, 2002), https://www.sec.gov/litigation/admin/34-44460 (citing Aaron v. SEC, 446 U.S. 680, 685 (1986)) (emphasis added).

138. *See* McFarland, *supra* note 123 (Musk "said his tweet was not meant to say that Tesla would certainly be taken private, but that he felt he had the funding necessary if shareholders chose to do so. 'I had no ill motive. I thought I was doing the right thing to make sure that shareholders were aware of the take private proposal.'").

139. After the verdict, the plaintiffs moved for judgment as a matter of law, or in the alternative, a new trial. The judge denied the motion, stating, "[t]here was substantial evidence from which the jury could conclude that the actual state of affairs did not differ from the term 'funding secured' in a way that would be significant to the reasonable

explained that "he wasn't persuaded by arguments that the tweets were material. 'The overall message, it just didn't land,' he told attorneys after the verdict was read. 'There was nothing there to give me an "aha" moment.'"[140] In the absence of a coherent *why*, the jury also likely concluded that even if Musk was reckless in making the statements (because they weren't clear enough or specific enough, or because he hadn't vetted certain things with counsel, things that turned out couldn't be done) he wasn't misstating things with an intent to deceive or defraud anyone.

Musk took the result in the private class action as vindication and immediately went to the court in the SEC action to try to undo the consent decree,[141] a move that went nowhere: the result in a private class action has no bearing on a public enforcement proceeding. But the result in the class action should nonetheless give the SEC pause: it was essentially the same case that was being litigated and while all juries are different, the verdict in the class action at least raises the very real possibility that if Musk had chosen to fight the SEC he might well have prevailed. But given the impact of the SEC filing on Tesla, Musk was in no position to do so.

V. CONCLUSION: SOME THOUGHTS ABOUT SEC ENFORCEMENT

When the SEC filed a litigated enforcement action against Musk, just seven weeks after the alleged misstatements, it must have seemed like the most straightforward case in the world. It certainly seemed that way to many commenters.[142] In retrospect, not so much.

To be clear, Musk's tweets were not appropriate. Whatever Musk may have been contemplating about taking Tesla private, the tweets were not the way to communicate that information to the public. The tweets included statements that were clearly false

investor." Order Denying Plaintiff's Motion for Judgment as a Matter of Law, and Denying Defendants' Motion for Costs, *In re* Tesla Inc., Sec. Litig. (N.D. Cal. June 14, 2023) (No. 18-cv-04865).

140. Elliott & Bobrowsky, *supra* note 129.

141. *See* Alison Frankel, *Column: Musk Says SEC Must Loosen Strictures After His Trial Win on 2018 Tweets*, REUTERS (Feb. 21, 2023, 4:54 PM), https://www.reuters.com/legal/column-musk-says-sec-must-loosen-strictures-after-his-trial-win-2018-tweets-2023-02-21/.

142. A typical statement from a prominent expert: "It's an easy case . . . He said in the tweet he had financing, and apparently he didn't . . . It's about as straightforward as you can get." Michaels et al., *supra* note 44.

(the prospective deal required more than just shareholder approval; there was no way for most individual shareholders to remain invested in a private Tesla) and statements that were at best ambiguous (there was no deal in place for financing); and the tweets omitted any kind of risk disclosure. Simply put, this is not how the Chairman and CEO of a large public company should act. And it's fair to say that given his position as Chairman and CEO of a large public company, Musk acted at least negligently (and *perhaps* even recklessly) when he sent out the tweets: he should have vetted all disclosures with company counsel and only made appropriate and completely truthful statements.[143]

But the SEC also acted recklessly here. Not because there wasn't a legal violation: there was, although on the facts presented, I am hard pressed to see scienter-based fraud, given the lack of any evidence of intent to deceive or defraud, or of recklessness that could rise to that level. And not because some sanction wasn't warranted: Elon Musk has been known to act rashly and impetuously, to speak off-the-cuff, to skirt the rules, to ignore legal advice, and to march to the beat of his own drummer, none of which aligns very well with the scope and design of the federal securities laws. If Elon Musk is going to be at the helm of a large public company, some restraint is in order. But the SEC needs to show some restraint as well.

In this case, the SEC was reckless because it filed a lawsuit against Elon Musk in which it sought to bar him from serving as an officer or director of Tesla (and any other public company), and it filed the lawsuit quickly when there were no exigent circumstances and when Musk's lawyers were apparently asking the SEC staff for more time to convince him to accept a settlement.[144] In this, the SEC itself was acting rashly and

143. There is an interesting side-question here about whether some disclosure was *necessary* in this case. While the standard for disclosure in the event of a takeover or merger is easy to state, it is often difficult to apply in practice. The legal standard comes from the case *Basic v. Levinson*, 485 U.S. 224, 238 (1988), and involves weighing the magnitude of the event and the probability of its occurrence. Because a takeover (or a taking private transaction) is a huge event for a company, even a moderate probability of occurrence may trigger disclosure obligations. Typically, lawyers will advise that disclosure is only required when there is some kind of firm commitment or at least an agreement in principle. But the case of Musk and Tesla may be different, at least if we accept Musk's view of events: Musk stated that he thought the probability of the taking private transaction going through was about 50% and he testified that he had the means to largely self-fund the transaction.

144. *See Tesla's Elon Musk, SEC Again Ask for More Time to Reach Deal Over CEO's Twitter Use*, REUTERS (Apr. 25, 2019, 8:36 PM), https://www.reuters.com/article/us-tesla-

impetuously, perhaps in a fit of pique that Musk had walked away from a settlement deal.

The filing was reckless because it was unnecessary at that time[145] and because the SEC staff had to know (or were reckless in not knowing) that the mere filing of a complaint seeking to remove Musk from running Tesla would have enormous market repercussions and would harm Tesla's shareholders. Indeed, the filing almost put Tesla into bankruptcy.

This brings us to the greater goals of SEC enforcement. The SEC sometimes acts as though enforcement is a goal in itself and that the sanctions it imposes are an end, not a means. SEC enforcement needs to be guided by the broader principles that inform the agency's mission: protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation. There may sometimes be tension between these goals (indeed, there may have been some in this case). But if so, the overarching principle should be some form of the Hippocratic oath: do no harm.

The most prominent example of the SEC reflexively seeking to punish alleged wrongdoers without regard to the protection of investors is with respect to the imposition of civil penalties. Over the past fifteen years, the SEC has become a fining agency. Last year the agency imposed nearly $4.2 billion in civil penalties,[146] the

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musk-sec/teslas-elon-musk-sec-again-ask-for-more-time-to-reach-deal-over-ceos-twitter-use-idUSKCN1S201T. It is true that defense counsel has sometimes used dilatory tactics to impede or frustrate SEC investigations, a practice that was recently criticized by the SEC Director of Enforcement. *See* Gurbir S. Grewal, *Remarks at Securities Enforcement Forum West 2022*, SEC (May 12, 2022), https://www.sec.gov/news/speech/grewal-remarks-securities-enforcement-forum-west-051222. But that was clearly not an issue here: the Complaint was filed a mere seven weeks after the offending conduct.

145. The only timing issue that is apparent is that the end of the fiscal year was approaching. The SEC's fiscal year ends September 30th, and there is typically a rush to file every possible case that could be filed before the end of the fiscal year, in part to bolster the numbers for that year. The timing of the filing also raises an interesting SEC internal process issue: the staff needs Commission approval to file a case as well as to settle a case, and the authority is typically sought at the same time if there is a settlement that has been worked out. If there was a settlement in place in this case (with certain charges and remedies) that Musk walked away from, the staff would have had to go back to the Commission to file the unsettled action with the enhanced charges. It is possible that the staff got authority in the alternative at the outset, but that is rare: it is much more likely that the staff had to go back to the Commission to file the unsettled action. Given the timing and the process of getting on the Commission calendar, that would mean it's possible that the staff got authority by going to the duty officer, a designated Commissioner who handles emergency actions. If that happened, it would mean that the unsettled action was approved by a single Commissioner. *See* 17 C.F.R. §§ 201.151(a), (c), 201.240(c)(3), (7).

146. Press Release, *supra* note 54.

highest amount ever in a single year and more than the three previous years combined.[147] The agency's enforcement director celebrated this milestone, indicating that fines would continue to be ratcheted up, including in cases involving mere negligence rather than willful misconduct.[148]

And boy have they! Last year, the agency obtained over $1.2 billion in fines from major financial institutions for violations of recordkeeping provisions, charges that involve only a showing of negligence.[149] The violations centered on the misuse of personal messaging devices and the failure to keep adequate records of communications. In all, seventeen firms were charged, nine of which agreed to pay $125 million each, while several other firms paid lower, but still significant, amounts.[150]

Large civil penalties are now a routine part of the resolution of almost all major SEC actions. But traditionally large fines were reserved for the most egregious cases, those involving fraud and other willful misconduct. The imposition of significant penalties in negligence cases highlights a significant problem with the fining regime. As previously noted, when civil penalties are imposed on public companies, the cost of the penalty is ultimately borne by the shareholders, who had nothing to do with the misconduct and have little or no control over those who did. Almost all of the firms charged in these recordkeeping cases were divisions or subsidiaries of public companies. This means that public investors indirectly paid over a billion dollars for the negligence of company employees. The settlements were framed as investor protection, but in the end, they were nothing more than a tax on shareholders of large Wall Street firms.

So, in the end, what should the SEC do with a problem child like the "incorrigible" Elon Musk? The answer is tread very carefully. The focus of SEC enforcement must be on protecting investors, not harming them. That means taking action against wrongdoers and imposing sanctions that are proportional to the

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147. Gurbir S. Grewal, Director, Div. of Enf't, Remarks at Securities Enforcement Forum (Nov. 15, 2022).

148. *Id.*

149. *See* Press Release, *supra* note 54.

150. *See* Press Release, SEC, SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures (Sept. 27, 2022), https://www.sec.gov/news/press-release/2022-174; Press Release, SEC, JPMorgan Admits to Widespread Recordkeeping Failures and Agrees to Pay $125 Million Penalty to Resolve SEC Charges (Dec. 17, 2021), https://www.sec.gov/news/press-release/2021-262.

harm, but it also means taking account of how SEC enforcement can cause its own harms, harms to the very people that enforcement is designed to protect. SEC enforcement can never be divorced from its ultimate goals, and if that means holding your nose a bit, so be it.