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INSIGHT: SEC's Tesla Experience May Lead to Refinements in Remedies Approach

BY CHARLES D. RIELY AND JEREMY H. ERSHOW

For decades, the Securities and Exchange Commission mainly used its injunction power to command defendants to obey the law—an approach that kept violators within the SEC's ambit and entitled the SEC to collateral relief in some instances, but did not provide an extra measure of protection to investors.

Defendants, after all, were already required to obey the law. The past decade, however, has seen a shift, as the SEC has ventured further and more ambitiously into crafting specialized equitable remedies specifically tailored to the offender.

One type, known as conduct-based injunctions, aims to protect the public by prohibiting defendants from engaging in otherwise legal activity, usually of the nature that landed them in trouble in the first place.

So-called undertakings go further, requiring defendants to assume affirmative obligations designed to proactively avoid the problems of the past.

SEC and Elon Musk's 'Undertaking' The commission's more sophisticated attempts to keep violators in line came fully into view with an October 2018 speech by the Enforcement Division's co-Director Steven Peikin. Peikin's speech described the division's priorities for non-monetary remedies, and in particular conduct-based injunctions and undertakings. He highlighted for the audience what was, at the time, the SEC's most recently obtained undertaking: the commitments made by Tesla CEO Elon Musk to erect a compliance regime around his tweeting practices.

The predicate for this settlement was Musk's infamous tweet that he had ''funding secured'' to take Tesla private at a valuation of $420/per share. Charged by the SEC with fraud, Musk's settlement agreement (memorialized in a consent judgment) required him to, among other things, comply with new Tesla policies requiring him to seek and obtain internal ''pre-approval of any [] written communications that contain, *or reasonably could contain*, information material to the Company or its shareholders.''

Peikin described this as a ''carefully tailored undertaking'' that ''impos[ed] closer oversight and control of Musk's communications.''

Then, in February, the SEC's use of the undertaking in the Tesla case was put to the test when the commission sought a contempt order against Musk for violating his undertaking agreement. The commission charged him with failing to obtain pre-approval from Tesla's internal control functions for tweets he made about Tesla's vehicle production projections.

The first tweet contained incorrect information that deviated from what the company previously told the market; the second tweet, a few hours later, clarified the first.

In vigorous briefing before Judge Alison Nathan of the U.S. District Court for the Southern District of New York, the commission took the position that the erroneous tweet was squarely the type of information that ''reasonably could contain information [that was] material,'' while Musk's attorneys countered that he exercised diligence to comply with the order and reasonably believed that the tweet was not material.

The court held a hearing on April 4, and reporters in the courtroom report that Judge Nathan openly mused on whether ''lack of clarity'' in the undertaking meant it needed to be modified. She reportedly told the parties to ''[t]ake a deep breath, put your reasonable pants on, and work this out.''

The result: Musk was not held in contempt, and he and the SEC agreed to an amended consent order that no longer called for any exercise of judgment as to what

was or was not material. Instead, the new undertaking imposed a flat requirement that Musk ''obtain the preapproval of an experienced securities lawyer employed by the Company of *any* written communication'' pertaining to any of several enumerated topics.

The revised undertaking thus specifically identifies the categories of information—including statements about Tesla's ''financial condition'', ''potential or proposed mergers'', ''production numbers or sales or delivery numbers'', ''new or proposed business lines'', and ''nonpublic legal or regulatory findings or decisions''—for which Musk must seek preapproval.

More Clarity Expected The SEC thus decided to accede to the court's desire for greater clarity rather than continue to argue about the meaning of the original pact. Whether the initial undertaking was less than clear, of course, is subject to debate.

The parties argued at length before Nathan, and one SEC commissioner released a statement after the revised pact was made public stressing he saw no ambiguity. In explaining why he could not support the revised settlement without an admission of wrongdoing from Musk, Commissioner Robert Jackson said it was ''crystal clear'' that Musk violated the initial deal.

The Tesla experience will likely lead the SEC to refine its approach to conduct-based injunctions and undertakings in the future. The case underscores that, to the extent the agency wants to invoke the contempt powers of the court, it must ensure that a conduct-based injunction or undertaking is clear and unambiguous.

The court's hesitancy to enforce the undertaking included in the initial settlement will likely lead the agency to avoid conduct-based injunctions and undertakings built around standards such as reasonableness whose precise meaning can be debated. Going forward, we can expect SEC undertakings to be built to a greater degree around black and white rules.

That's probably a good thing for all parties involved. From the SEC's perspective, rules leave less room for debate and mean its settlements will be enforced as intended. On the other side of the coin, defendants and their counsel will have the benefit of clearer rules around which to conform their behavior.

And of course, that also means less of a chance of landing in messy, expensive litigation on points of ambiguity. That's efficient for everyone, and especially important for defendants who make good faith efforts to improve their behavior and live up to their commitments to the SEC.

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Author Information

Charles D. Riely, a partner in Jenner & Block's Investigations, Compliance and Defense Practice, is a former assistant regional director for the Division of Enforcement for the Securities and Exchange Commission with significant experience in all aspects of the federal securities laws.

Jeremy H. Ershow is a senior associate in the firm's Securities Litigation and Enforcement group.