

The Elon Musk circus is about to enter a new arena: federal court

By RUSS MITCHELL AND ALEXA DIAZ
TIMES STAFF WRITERS

Elon Musk's contempt toward the U.S. Securities and Exchange Commission — as expressed in numerous tweets and in a national TV appearance — is beyond question.

Whether the Tesla chief executive violated contempt-of-court charges filed against him by the SEC is for a judge to decide.

On Monday, Musk must file a brief in his defense under orders from Judge Alison Nathan, 46, of the U.S. District Court for the Southern District of New York.

Nathan, who has yet to schedule a hearing, will decide whether Musk defied a previous fraud settlement with the SEC when he tweeted out what seemed to be a huge increase in Tesla's forecast for electric-car production for 2019. And, if so, what she's going to do about it.

Pundits are predicting everything from a slap on the wrist to removing Musk from his CEO position. If the Obama-appointed judge issues an order and Musk later violates that, it could lead to



Tesla CEO Elon Musk is defending himself on contempt-of-court charges filed against him by the SEC. (Evan Vucci / AP)

criminal, not civil, contempt, with jail as a possibility.

The judge suddenly finds herself a key character in the soap opera that stars the celebrity billionaire.

Her decision is likely to affect the course of corporate governance at troubled Tesla Inc., and it may send a message to business executives about how much the courts will let them get away with if they violate court-approved orders.

Jail time or job loss are highly unlikely at this time, legal experts

said — civil contempt remedies are aimed at compliance, not punishment. But there is little court precedent for what's to come.

"I can't think of another case like this," said Irving Einhorn, retired lawyer and regional administrator of the SEC's Los Angeles office in the 1980s. "Elon Musk is unique, he really is."

Because business executives charged by the SEC tend to follow court orders, there aren't many contempt cases to serve as precedent, said Peter Haveles, attorney

and financial law specialist at law firm Pepper Hamilton. “If they thumb their nose at the SEC, they are undercutting their ability to engage in business in the future.”

Musk already is barred from serving as Tesla’s chairman for three years. The SEC unseated Musk last September after charging him with securities fraud for tweeting that he had secured funding for an \$80-billion deal to take Tesla private at a significant premium to the stock price. No such deal had been struck.

Musk settled the charges with the SEC. He did not admit to guilt. Under the terms of the deal, he cannot deny he committed fraud. He agreed to pay a \$20-million fine out of his pocket, not from Tesla’s treasury. Most pertinent to the recent contempt charges, Musk consented to company “preapproval” of “written communications, including social media posts, that contained or reasonably could contain information material to Tesla or its shareholders.”

Nonetheless, on Feb. 19, Musk tweeted that “Tesla made 0 cars in 2011, but will make around 500k in 2019.” A few hours later, he tweeted that he “meant to say” that’s an annualized rate, and that about 400,000 cars will be delivered this year. A 100,000-car difference translates into billions of dollars in revenue.

The damage, however, was done, in the eyes of the SEC. It filed contempt charges on Feb. 25, saying Musk failed to have the

Feb. 19 tweet approved by a company attorney as required.

The proceedings might reveal who Musk’s “Twitter sitter” is at Tesla, and his or her dealings with Musk. (Whether it was a coincidence or not, corporate counsel Dane Butswinkas quit the company the next day to return to his law firm after two months at Tesla.)

There’s not much of a court record to indicate Judge Nathan’s attitude toward civil contempt or its remedies. In a 2017 case involving alleged false advertising of pregnancy test kits, the judge found no contempt but did comment on what’s necessary to prove it:

“A party may be held in civil contempt only where the plaintiff establishes the decree was clear and unambiguous, and the proof of noncompliance is clear and convincing.

“Although the defendant’s conduct need not be willful,” she continued, “a plaintiff must also prove that the defendant has not been reasonably diligent and energetic in attempting to comply.”

Whether the shade Musk threw on the SEC following his settlement will become part of the court record is yet to be determined. On Oct. 4 he tweeted that “the Short-seller Enrichment Commission is doing incredible work,” a reference to stock investors who bet a company’s shares are overpriced. In December, interviewed on television’s “60 Minutes,” he said, “I do not respect the SEC. I do not respect them.”

Musk was already drawing criticism from pundits for his temerity, but the dam broke after the contempt filing.

Jim Cramer, the hyperactive host of CNBC’s “Mad Money,” marveled that the message from the SEC was “don’t you ever poke our eye again — and he does it!” In a streaming video interview with The Street, Cramer said: “The SEC at a certain point is going to be so antagonized that they’ll call down one of the outside directors and say, ‘Listen, you’re the head’” of the company.

Lloyd Greif, head of Los Angeles investment bank Greif & Co., said the original SEC settlement was “barely a rap on his knuckles. And it didn’t take very long for Elon to violate his probation. I think the SEC is going to come down on him like a ton of bricks.”

The SEC and Tesla declined to comment.

However, there are no hints of brick dropping or other remedies in the SEC’s contempt complaint. Such filings often include suggested actions for a judge to consider, but in this case, the SEC punted, leaving any remedies solely up to the judge.

In a recent Wall Street Journal column, “Crazy Elon vs. the SEC, Round Two,” Holman Jenkins posited that “The SEC usually likes to show up after a bubble and hand out penalties. It hardly craves to be seen pushing a company’s shares off a cliff while millions of investors still have faith in its glorious future.”

Experts in securities law point out that, in this case, the judge will be guided by civil, not criminal, contempt procedures. Criminal contempt usually ends in punishment. “The point of civil contempt is to ensure compliance and to deter disregarding the order,” attorney Haveles said.

Musk’s culpability on the charge seems pretty clear to Haveles: “The SEC will say, however trivial [the tweet], he didn’t follow the order and didn’t respect the court. I think the judge will agree and find him in contempt. That’s the easy part.”

Harvey Pitt, SEC chairman in the George W. Bush administration, said the judge will decide what incentives can be applied so Musk will obey his promises to the court. “In one way or another, remedies will need to focus on repressing his irrepressibility,” he said.

“There needs to be enough of a disincentive that Musk won’t do it again,” Haveles said. “I think there will be a fine and a stern warning,” and the judge will say, “I don’t want to have this back in my courtroom again, because next time I will be much harsher.”

A non-billionaire might wonder why a multimillion-dollar fine would have much effect on Musk, whose company stock is currently worth about \$48 billion. To pay another fine, Musk could sell stock, or dig into his cash account. However, Musk selling stock could send Tesla’s price down,

perhaps to levels that would affect his net worth.

A financial filing in April 2018 revealed that nearly 40% of Musk’s stock is pledged as collateral for hundreds of millions of dollars in personal loans from Morgan Stanley and other banks. Musk uses the money to pay for his Bel-Air mansions, his private plane and other extravagances. If the stock drops low enough — some analysts calculate the low \$200s, though there’s no way to be sure — Musk would have to pay off loans or pledge new shares.

But the judge could go beyond a fine if she wanted to. She could even order him off Twitter — a devastating sentence for a mogul who has used social media to build a cult following.