

M&A Update

Delaware Chancery Court Finds Elon Musk May Be Controlling Stockholder of Tesla Motors

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On March 28, 2018, in *In re Tesla Motors, Inc. Stockholder Litigation*, the Delaware Court of Chancery denied a motion to dismiss a lawsuit brought by stockholders of Tesla Motors, Inc. (“Tesla” or the “Company”). The plaintiffs alleged that Tesla’s Board of Directors, along with its Chairman and CEO, Elon Musk, breached their fiduciary duties by approving the \$2.6 billion acquisition of SolarCity, which allegedly benefitted SolarCity stockholders to the detriment of Tesla stockholders. At the time of the transaction, Mr. Musk was the Chairman of the Board, Chief Executive Officer and Chief Product Architect of Tesla, and owned approximately 22.1% of Tesla’s outstanding common stock. He was also Chairman of the Board of SolarCity and SolarCity’s largest stockholder, owning approximately 21.9% of SolarCity’s outstanding common stock. In their motion to dismiss, the defendants argued that Mr. Musk was not a controlling stockholder of Tesla and that, because the transaction was approved by an uncoerced, fully informed majority vote of disinterested stockholders, the transaction should be reviewed under the deferential business judgment rule in accordance with *Corwin v. KKR Financial Holdings LLC*. The Court denied the motion to dismiss and found that “it is reasonably conceivable that Musk, as a controlling stockholder, controlled the Tesla Board in connection with the Acquisition.” If so proven, the transaction will be reviewed under the more stringent entire fairness standard. The decision is the latest in a line of cases (as discussed in our prior [alerts](#)) in which Delaware courts have found that minority stockholders can, in certain circumstances, exercise corporate control.

Background

The *Tesla* Court was tasked with determining whether or not it was “reasonably conceivable” that Elon Musk was a “controlling stockholder” of Tesla, or, in other words, whether Mr. Musk “exercise[d] control over the business affairs of [Tesla]” and “exercised actual domination and control over...[the] directors...so potent that independent directors...[could not] freely exercise their judgment.”

Although deeming it a “close call,” the Court concluded that the allegations led to a reasonably conceivable inference that Mr. Musk was controlling stockholder. The Court ultimately found persuasive allegations of: (1) Mr. Musk’s ability to influence the stockholder vote to effect significant

change at Tesla, including the removal of Board members; (2) Mr. Musk's influence over the Board as Tesla's visionary, CEO and Chairman of the Board; (3) Mr. Musk's strong connections with members of the Tesla Board and the fact that a majority of the Tesla Board may have been "interested" in the acquisition; and (4) Tesla's and Mr. Musk's acknowledgement of Mr. Musk's control in Tesla's public filings.

Takeaways

- A Stockholder Owning Less than a Majority of Outstanding Shares May Nonetheless be a Controlling Stockholder. The Court rejected the defendants' argument that the "delta" between Mr. Musk's 22.1% stake and actual voting control was too great, as a matter of law, to deem Mr. Musk a controlling stockholder. Instead, the Court found that "[t]he focus of the [controller] inquiry [is] on the *de facto* power of a significant (but less than majority) shareholder, which, when *coupled with other factors*, gives that shareholder the ability to dominate the corporate decision-making process."
- Delaware Courts Will Consider Circumstantial Evidence, Including Deal Terms, in Making Controlling Stockholder Determinations. The Court found convincing the circumstantial evidence presented by the plaintiffs in considering whether Mr. Musk was a controlling stockholder of Tesla. For example, the Court cited the weak financial state of SolarCity at the time of Tesla's offer and ultimate agreement to acquire the company, including SolarCity's significant liquidity issues that put the company on the verge of bankruptcy. The Court also observed that the SolarCity stock price had decreased approximately 64% between February 2015 and February 2016, SolarCity was subject to a lawsuit alleging that it misappropriated trade secrets and intellectual property relating to critical solar cell shingling technology, and Tesla had become aware through due diligence that SolarCity faced significant challenges in operating and funding its new manufacturing facility in Buffalo, New York. Despite these challenges, Mr. Musk, on three different occasions over a three-month period, presented a plan for acquiring SolarCity to the Tesla Board, and ultimately gained Tesla Board approval for the transaction. Moreover, the Tesla Board did not discuss any alternative transactions during its deliberations, even in the face of recent statements by Goldman Sachs that SolarCity was "the 'worst positioned' company in the solar energy sector for capitalizing on future growth in the industry," and relied on a discounted cash flow analysis conducted by Tesla's financial advisor that used projections that had been modified by Mr. Musk himself to make the transaction appear more favorable to Tesla. In light of the foregoing, the Court appeared to credit as plausible, at least at the motion to dismiss stage, the plaintiffs' characterization of the transaction as a "bail-out," with a price so one-sided that it further revealed that the Board was dominated by Musk when voting to approve the acquisition, rather than the product of a good faith, arms-length negotiation.
- Delaware Courts Will Examine a Stockholder's Past Behavior and Current Status at the Company in Making the Control Determination. The Court stated that Mr. Musk's undisputed status as the "face of Tesla" was not dispositive in determining whether Mr. Musk was Tesla's

controlling stockholder. Instead, the Court pointed to the impact his past behavior and current status at the Company may have had on the Board's decision-making process. *First*, the Court observed that Mr. Musk had "demonstrated a willingness to facilitate the ouster of senior management when displeased," citing an instance in 2008 in which Musk replaced the founder and former CEO of Tesla as CEO. The Court added that it was conceivable that Tesla Board members had not forgotten this ouster when considering the SolarCity proposal eight years later. *Second*, the Court stated that the Tesla Board was well aware of Mr. Musk's "singularly important role in sustaining Tesla in hard times and providing the vision for the Company's success," having significantly contributed to the operational, financial and recruiting success of Tesla, published a public "manifesto" of Tesla's strategy that was "apparently the product of his mind alone" and infused capital into the Company during times of financial hardship. *Third*, Mr. Musk made a number of public statements both prior to and following Tesla's public disclosure of its offer to acquire SolarCity that were supportive of the transaction.

- A Minority Stockholder Must Actually Exercise His or Her Control Over the Corporation and/or Board of Directors in Order to Be Considered a Controlling Stockholder for Purposes of a Challenged Transaction. The Court observed that having control, but not using it, will not lead to a finding that the stockholder is a "controlling stockholder" for purposes of a particular transaction. The Court referenced a similar dispute regarding the [management buyout of Dell, Inc.](#) in which Dell, Inc.'s founder and CEO, Michael Dell, was found not to be a controlling stockholder. Although Mr. Dell and Mr. Musk are both highly visible and important figures in regards to their respective companies, the Court distinguished the Dell buyout from the Musk-led acquisition of SolarCity by Tesla based on the respective Board members' independence from the influence of the firms' CEOs. Unlike Mr. Musk, who actively pursued the SolarCity transaction, did not explore alternative transactions, chose the advisors that were to represent Tesla and its Board with respect to the transaction and led the Board's deliberations of the transaction, Mr. Dell did not participate in any board level discussions about a sale of Dell and committed to work with competing bidders. The Dell board also took care to create an independent special committee in order to evaluate the transaction. On the other hand, Tesla did not form an independent special committee despite having independent board members who could have served. According to the Court, "there were practically no steps taken to separate Musk from the Board's consideration of the Acquisition."
- The Court Will Consider Board-Level Conflicts in Determining Whether the Board Could Exercise Independent Judgment Outside of the Alleged Controlling Stockholder's Influence. The Court stated that, while even the decision-making of an independent and disinterested director may be dominated by a controlling stockholder, a director is less likely to resist the wishes of a controlling stockholder if he or she is likely to benefit from the proposed transaction. With Mr. Musk and Board member Antonio Gracias recusing themselves from the vote, only five Tesla Board members considered the transaction. The Court noted that Tesla conceded in SEC filings that two of the five Tesla Board members who approved the SolarCity acquisition were not

independent: one director, Brad Buss, served as SolarCity's Chief Financial Officer from August 2014 until February 2016, receiving \$32 million in compensation, and a second is Mr. Musk's brother, Kimbal. A third director, Stephen Jurvetson, had served on the Tesla Board for almost a decade at the time of the transaction and had received lavish gifts from Mr. Musk, including the first Tesla Model S and second Tesla Model X ever made. Mr. Jurvetson also invested in Tesla three times through his venture capital firm and had substantial ties to other entities in which Mr. Musk was involved, including SolarCity. As a result, the Court felt that it was reasonably conceivable that a majority of the five Tesla Board members who approved the transaction were not independent, strengthening the plaintiffs' argument that the Board was not free of Mr. Musk's influence in approving the SolarCity transaction.

- Public Statements Made by the Company or by the Alleged Controlling Stockholder Regarding the Stockholder's Influence Are Relevant. The Court relied on prior public statements by Tesla and Mr. Musk in considering Mr. Musk's status as a controlling stockholder. For example, Tesla's SEC filings included various statements regarding Mr. Musk's importance to the Company, including disclosure regarding Mr. Musk's role in "recruiting executives and engineers, contributing to the Tesla Roadster's engineering and design, raising capital for us and bringing investors to us, and raising public awareness of the Company," as well as a risk factor providing that "[Tesla is] highly dependent on the services of Elon Musk, [who is] highly active in [the Company's] management, [and if Tesla were to lose his services, it could] disrupt our operations, delay the development and introduction of our vehicles and services, and negatively impact our business, prospects and operating results as well as cause our stock price to decline." Moreover, Mr. Musk often referred to Tesla as "my company," published two "Master Plans" in which he describes his strategic direction for Tesla, previously stated that had he not become CEO of Tesla "the company wasn't going to make it" and labelled Tesla, SolarCity and SpaceX as a "pyramid" on top of which he sits.

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- Questions regarding this M&A Update can be directed to your Cadwalader contact or to any of the following attorneys.

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