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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RICHARD J. TORNETTA, Individually and on Behalf of All Others Similarly Situated and Derivatively on Behalf of Nominal Defendant TESLA, INC., Plaintiff, v. ELON MUSK, ROBYN M. DENHOLM, ANTONIO J. GRACIAS, JAMES MURDOCH, LINDA JOHNSON RICE, BRAD W. BUSS, IRA EHRENPREIS, STEVE JURVETSON, and KIMBAL MUSK, Defendants, and TESLA, INC., a Delaware corporation, Nominal Defendant.	C.A. No. 2018-0408-JRS

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS THE COMPLAINT

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PRELIMINARY STATEMENT

In 2012, Tesla's board of directors approved an unusual and ambitious CEO compensation plan. Under the plan, Tesla's CEO, Elon Musk, would be paid no guaranteed compensation of any kind—no salary, no cash bonuses, and no equity awards that automatically vest with the passage of time. Instead, Musk would receive only performance-based options, with each batch of options vesting only if the company met both a market capitalization growth target and an operational goal. And the milestones were audacious. For example, each market capitalization milestone required Tesla to grow by $4 billion, from a starting market capitalization of only $3.2 billion.

The plan thus ensured that Musk would be paid if—and only if—he succeeded in driving very substantial increases in stockholder value. The plan also ensured that Musk would be paid nothing for anything less than that. If Tesla's results fell short of the required milestones—even by a penny—the options contingent on those milestones would not vest. The board set the plan's term at ten years, believing it would take Musk at least that long to meet all the milestones, if he could meet them at all.

But only five years later, Musk had achieved all but two of the twenty milestones, with Tesla's market capitalization having grown more than ten times, rivaling that of General Motors. As a result, like many CEOs, Musk was very well paid. But unlike other CEOs, he was paid only because he delivered tens of

billions of dollars in actual stockholder returns. He was not just paid for performance—he was paid only for extraordinary performance.

When the Tesla board returned to the drawing board to craft Musk's new compensation package, it viewed the 2012 plan as a model that had effectively aligned CEO pay with the interests of Tesla's stockholders. So the board approved a new plan, the 2018 Performance Award, which made 100% of Musk's compensation contingent on the achievement of herculean milestone requirements that were even more ambitious than those set by the 2012 plan.

The 2018 Performance Award consists entirely of stock options that vest only if Musk meets market capitalization goals each requiring $50 billion in growth—that is, growth equal to Tesla's entire market cap when the Award was approved—*and* meets operational targets requiring aggressive revenue and profit growth. Under the plan, Musk vests in the full award only if he leads Tesla to a market capitalization of *$650 billion* and unprecedented revenues and earnings within the next ten years. To put that in perspective, Tesla, currently valued at about $50 billion, does not rank even in the top 100 companies by market capitalization. If Musk succeeds in driving Tesla to a $650 billion valuation, it would be the fifth most valuable company in the world, behind only Apple, Amazon, Google, and Microsoft.

If Tesla does not at least double in value, however, Musk will get nothing—even if Tesla otherwise experiences excellent growth. Musk will receive no guaranteed compensation of any kind: no salary, no cash bonuses, and no stock

options that automatically vest with the passage of time. One hundred percent of his compensation is at risk, and he will be paid only if Tesla's stockholders enjoy extraordinary returns.

Plaintiff brings suit objecting to this overwhelmingly stockholder-friendly pay plan. He asserts that demand is excused because a majority of the Tesla board is not independent of Musk. Defendants deny that demand is excused. But out of respect for this Court's recent pleadings-stage decision in *In re Tesla Motors, Inc. Stockholder Litigation*, Consol. C.A. No. 12711-VCS, defendants will not move to dismiss plaintiff's claims under Court of Chancery Rule 23.1. The complaint is still subject to dismissal, however, because it fails to state a claim upon which relief can be granted for two independent reasons:

(1) Tesla's disinterested stockholders approved the 2018 Performance Award at a special meeting in a vote not alleged to be coerced or less than fully informed. That affirmative vote of a majority of the disinterested stockholders present and entitled to vote at the special meeting constituted a ratification of the option grant. Plaintiff alleges that slightly less than half the disinterested shares outstanding voted to approve the Award. But the relevant standard for ratification of non-extraordinary transactions like a grant of options is a majority of the disinterested shares present at the meeting, not a majority of the disinterested outstanding. There is no basis in the corporation statute or the case law to subject a vote on the grant of options to a majority-of-the-outstanding standard. The 2018

Performance Award is accordingly susceptible to attack in the courts only on the ground that it is waste—which the complaint does not come close to pleading.

(2) The complaint is also subject to dismissal because it fails to plead facts demonstrating the unfairness of the 2018 Performance Award. Even assuming the Award is subject to the entire fairness standard, Delaware law is clear that the complaint must still plead facts demonstrating the unfairness of the transaction in order to state a claim. The complaint here pleads no facts showing that the 2018 Performance Award was the product of an unfair process. Nor does it plead any facts showing that the "price" of the 2018 Performance Award—that is, the relationship between the (contingent and hypothetical) consideration Musk could earn and the value stockholders stand to receive—is unfair. That is because the Award is the ultimate pay-for-performance plan. As the complaint's own allegations establish, the 2018 Performance Award rewards Musk only if the stockholders that plaintiff purports to represent have already benefited from massive growth in the value of their Tesla investment.

BACKGROUND

This summary of allegations is set out for purposes of this motion only and assumes the truth of the facts alleged in the complaint, including documents incorporated therein. Citations in the form of "¶ __" are of the complaint. Before filing this lawsuit, plaintiff inspected Tesla documents made available pursuant to 8 *Del. C.* § 220. The parties have agreed that "all documents produced in response to [plaintiff's inspection demand] shall be deemed incorporated by reference into any . . . complaint" plaintiff files that is "based in whole or in part on any documents made available for inspection." Confidentiality Agreement at ¶ 8 (Apr. 11, 2018). *See Amalgamated Bank* v. *Yahoo! Inc.*, 132 A.3d 752, 796-97 (Del. Ch. 2016). These documents are thus before the Court on this motion as though pleaded in the complaint.[1]

A. Tesla, its board of directors, and its CEO

Tesla is a Delaware corporation headquartered in Palo Alto, California. ¶ 9. Tesla designs, develops, manufactures, and sells electric vehicles and energy generation and storage systems. *Id.*

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[1] Plaintiff's § 220 materials are cited herein as "TESLA__." The record also includes public filings that are incorporated by reference into the complaint. *See Olenik* v. *Lodzinski*, 2018 WL 3493092, at *1 & n.3 (Del. Ch. July 20, 2018) (noting that on a motion to dismiss the Court may consider documents that are "incorporated by reference" into the complaint and may take judicial notice of facts in SEC filings that are "not subject to reasonable dispute"). These documents, together with relevant § 220 materials, are included as exhibits to the Transmittal Affidavit of Garrett B. Moritz filed contemporaneously (cited herein as "Ex. __.")

Elon Musk ("Musk") is Tesla's Chairman, CEO, and Chief Product Architect. ¶ 22. The other eight members of Tesla's board are all outside directors. All but one of the outside directors (Kimbal Musk, Elon's brother) are independent under the NASDAQ rules. Ex. 20 (Tesla Apr. 26, 2018 Proxy) at 18.

Musk is also the Chairman, CEO, Chief Technology Officer, and majority stockholder of SpaceX, which is valued at $21 billion, making it one of most valuable privately held companies in the world. ¶ 10 & n.1. Musk, who is one of the co-founders of PayPal, also recently co-founded The Boring Company, an infrastructure company, and Neuralink Corp., a developer of brain-machine interfaces. Ex. 20 (Tesla Apr. 26, 2018 Proxy) at 9.

B. Tesla's historical performance and CEO compensation

Musk "has contributed significantly and actively to [Tesla] since [its] earliest days in April 2004 by recruiting executives and engineers, contributing to the Tesla Roadster's engineering and design, raising capital for . . . and bringing investors to [Tesla], and raising public awareness of the Company." ¶ 24. Musk became Tesla's chairman in 2004 and has led its strategic planning since. ¶¶ 10, 26. In 2006, Musk drafted a "Master Plan" setting forth Tesla's strategic goals—to build increasingly affordable electric cars and, eventually, to provide solar power. ¶ 26. Two years later, in 2008, Musk became Tesla's CEO. ¶ 10.

At that time, Musk received $1 per year in annual salary for his services. Ex. 12 (Tesla Jan. 29, 2010 Form S-1) at 131, 134. He did not receive any equity compensation until December 2009, when he was awarded options contingent on

his continued service that vested on a three-year schedule, as well as options contingent on his achievement of specified operational milestones. *Id.* at 71-72.

After Tesla went public in 2010, Musk continued to receive only $1 per year in annual salary. Ex. 14 (Tesla Apr. 17, 2013 Proxy) at 22. In 2010 and 2011, he did not receive any equity grants because the Compensation Committee of the Tesla board determined the grants made in December 2009 already sufficiently motivated him to perform his duties as CEO. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 5.

By 2012, Musk was on the verge of meeting the last of the operational milestones linked to the December 2009 option grant. Ex. 13 (Tesla Feb. 27, 2012 Form 10-K) at 4. So the Compensation Committee retained an outside compensation consultant and undertook a review of Musk's compensation arrangements. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 5. Following that review, the Committee recommended, and the Tesla board approved, the issuance of a new, entirely performance-based, option award to Musk. *Id.*

That award (the "2012 Performance Award") consisted of stock options divided into ten equal tranches, each tranche representing 0.5% of Tesla's outstanding shares as of the date of the grant. *Id.* The vesting of each tranche was contingent on the achievement of both a market capitalization milestone and an operational milestone. *Id.* at 6. Musk received no other compensation and so would receive nothing at all if Tesla failed to meet the pre-determined milestones set by the 2012 Performance Award. If he failed to meet the milestones for a

tranche before the ten-year term of the 2012 Performance Award expired, the options in that tranche would be forfeited. Ex. 2 (June 23, 2017 Comp. Consultant Presentation) at TESLA_22.

The milestones of the 2012 Performance Award were ambitious. Each of the ten market capitalization milestones marked an increase of $4 billion in Tesla's market value. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 7. That increment was larger than Tesla's entire market capitalization of only $3.2 billion when the 2012 Performance Award was made. The ten operational milestones required the design and production of two new vehicle models, including Tesla's first mass-market model, and significant increases in the production of Tesla's Model S, overall vehicle production, and gross margin. *Id.*; Ex. 2 (June 23, 2017 Comp. Consultant Presentation) at TESLA_22.

As the Tesla board noted in its disclosure of the 2012 Performance Award, Musk could earn the full award only if, within ten years, Tesla met all of the operational milestones and achieved a market capitalization comparable to that of General Motors and Ford, century-old companies that have been global industry leaders for decades. Ex. 14 (Tesla Apr. 17, 2013 Proxy) at 23. The Tesla board, which had designed the 2012 Performance Award to take "many years to achieve, if at all," therefore viewed the milestones as "very challenging." Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 6.

Yet, in 2017, less than five years into the ten-year term of the 2012 Performance Award, Musk had led Tesla past not only the final market

capitalization milestone but also the market capitalizations of General Motors and Ford. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 2. And Musk was also on track to steer Tesla past all but one of the ten operational milestones by the end of the year. *Id.*

With Tesla approaching completion of the original Master Plan for its business that Musk had written ten years before, Musk drafted a new strategic plan (the "Master Plan, Part Deux") that identified a new series of long-term goals for Tesla. Those goals included expanding the company's electric vehicle product line to cover all major forms of automotive transport, developing safe self-driving capability, facilitating commercial car-sharing of consumer-owned cars, and creating solar products, such as a roof with integrated battery storage to power homes and cars. ¶ 26; https://www.tesla.com/blog/master-plan-part-deux.

Recognizing the importance of Musk's managerial leadership to its success, Tesla disclosed in public filings that it "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." ¶ 24.

C. The board's consideration and approval of the 2018 Performance Award

As Tesla approached achievement of the 2012 Performance Award's final milestones in mid-2017, the Compensation Committee of the Tesla board began to consider a new compensation arrangement for Musk. Ex. 1 (June 23, 2017 Comp.

Committee Minutes) at TESLA_1. The Committee retained outside counsel and an outside compensation consultant, Compensia, the same firm that had assisted the board in designing the 2012 Performance Award. *Id*. at TESLA_2. Because of the importance of its task, the Committee also solicited the input of the other outside directors (except for Kimbal Musk). *See, e.g.*, Ex. 5 (Aug. 1, 2017 Comp. Committee Minutes) at TESLA_129.

The Committee recognized that Musk had been a key driver of the company's success and concluded that the interests of Tesla and its stockholders would be served by a compensation plan that incentivized him to devote as much of his time and attention to Tesla as possible. Ex. 1 (June 23, 2017 Comp. Committee Minutes) at TESLA_1. The need to incentivize Musk to remain a fully engaged CEO was especially acute, in the Committee's view, because he also managed other large, successful companies. *Id*. The directors believed that the 2012 Performance Award had succeeded in directly aligning Musk's compensation with stockholder interests because he was entitled to compensation only if he met challenging milestones and because he received zero compensation for growth in stockholder value—even substantial growth—that fell short of those milestones. *Id*. at TESLA_2. The Committee also found it significant that stockholders had overwhelmingly supported the company's executive compensation policies, including the 2012 Performance Award, in past "say-on-pay" votes. *Id.* For these reasons, the Committee determined that the framework of the 2012 Performance

Award provided a useful starting point as it considered how to structure a new compensation package. *Id.*

In devising a new award, however, the Committee sought to make the value-creation and operational goals even more favorable to stockholders. Ex. 3 (July 7, 2017 Comp. Committee Minutes) at TESLA_26; Ex. 4 (July 7, 2017 Comp. Consultant Presentation) at TESLA_106. The Committee thus considered a structure that had the same ten-year term as the 2012 Performance Award, but with market capitalization milestones of $50 billion in incremental value rather than $4 billion. *Id*. at TESLA_107, TESLA_110. Each of these $50 billion increments was equivalent to Tesla's entire market cap at the time. *Id*. at TESLA_128. To meet even one milestone and obtain any compensation at all, Musk would have to roughly *double* Tesla's market capitalization. *Id.* To meet all twelve milestones, Musk would have to lead Tesla, whose market capitalization did not rank even in the top 100 of public companies, to a value that would make it one of the five most highly valued public companies in the world. *Id.* And he would have to do that in only ten years.

Compensia confirmed that these milestones were not merely difficult, but that they appeared to be the *most* difficult performance standards imposed by any CEO pay plan of which it was aware. "Based on our review of market practices," Compensia told the Committee, the contemplated award would "provide a larger compensation opportunity to the CEO than we have observed in the market, but will be tied to performance goals that appear more challenging than any others we

have observed (e.g., entire multiples of the current market cap will be required to earn the award)." Ex. 4 (July 7, 2017 Comp. Consultant Presentation) at TESLA_106.

Another compensation consulting firm that the Tesla board had considered hiring also expressed the view that the contemplated performance requirements were as aggressive and stockholder-friendly as any it was aware of. ¶ 40 ("What others consider highly leveraged plan designs with very aggressive performance requirements will not meet the standard that you are considering. The closest comparison will be the grant you made in 2012.").

At the Committee's request, Committee Chairman Ira Ehrenpreis and Tesla's general counsel solicited the view of the company's fifteen largest institutional stockholders about the 2012 Performance Award and the design of a potential new CEO compensation arrangement. Ex. 3 (July 7, 2017 Comp. Committee Minutes) at TESLA_26; Ex. 5 (Aug. 1, 2017 Comp. Committee Minutes) at TESLA_130; Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 5. Many of these institutional stockholders expressed enthusiasm about the structure and results of the 2012 Performance Award, and indicated that they favored a new award that would be similarly designed. *Id.*; Ex. 5 (Aug. 1, 2017 Comp. Committee Minutes) at TESLA_130. Although these stockholders suggested various metrics for the operational milestones, they generally advocated financial metrics that would make top-line (revenue) and bottom-line (profit) growth conditions to vesting. Ex. 8

(Sept. 19, 2017 Board Minutes) at TESLA_265; Ex. 9 (Nov. 16, 2017 Board Minutes) at TESLA_268.

In designing a new compensation arrangement, the Committee accorded substantial weight to the view of these large institutional stockholders. *Id.*; Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 5. The Committee thus worked with its advisors to identify a set of operational milestones that required revenue growth (in the form of annual revenue targets) and profitability (in the form of annual adjusted EBITDA targets). Ex. 9 (Nov. 16, 2017 Board Minutes) at TESLA_268.

In the following months, the members of the Committee met repeatedly with Musk to discuss the objectives of a potential new compensation arrangement and to negotiate its terms. Ex. 7 (Sept. 8, 2017 Comp. Committee Minutes) at TESLA_206; Ex. 8 (Sept. 19, 2017 Board Minutes) at TESLA_264-65; Ex. 9 (Nov. 16, 2017 Board Minutes) at TESLA_267; Ex. 10 (Dec. 12, 2017 Board Minutes) at TESLA_269. In particular, they and Musk negotiated the milestones on which vesting of options would be conditioned and the overall size of the option grant, as well as whether the size of the grant should be determined as a percentage of current total outstanding shares or as a percentage of fully diluted shares at the time of vesting. Ex. 9 (Nov. 16, 2017 Board Minutes) at TESLA_267.

The Committee and Musk ultimately agreed to a structure similar to that of the 2012 Performance Award, in which the option award would be divided into twelve equal tranches, each contingent on the achievement of both market capitalization and operational goals within ten years following the grant. Musk

agreed to accept the most challenging market capitalization milestone increment proposed by the Committee—$50 billion. Ex. 10 (Dec. 12, 2017 Board Minutes) at TESLA_269. Musk also agreed to the proposed operational milestones tracking growth in annual revenue and adjusted EBITDA. *Id*. at TESLA_270. The agreed-upon annual revenue milestones ranged from $20 billion to $175 billion; the adjusted EBITDA milestones ranged from $1.5 billion to $14 billion.[2] Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 9. The board viewed these as "challenging hurdles." *Id*. at 12. Just the first of the revenue targets requires Tesla to triple its 2016 revenue—meaning it would have to realize more revenue in a single year than it has realized since its inception. The profitability milestones also require unprecedented performance, given that Tesla has consistently reported net losses.

[2] Achievement of an operational milestone is determined by the aggregate total revenue or adjusted EBITDA of the previous four consecutive fiscal quarters. There are more operational milestones (16) than there are market capitalization milestones (12) and vesting tranches (12), but Musk is not required to meet more than one operational milestone (in addition to one market capitalization milestone) per tranche to earn the options in that tranche. The individual operational milestones are shown below:

Total Revenue (in billions)	**Adjusted EBITDA (in billions)**
$20.0	$1.5
$35.0	$3.0
$55.0	$4.5
$75.0	$6.0
$100.0	$8.0
$125.0	$10.0
$150.0	$12.0
$175.0	$14.0

See Ex. 17 (Tesla Mar. 1, 2017 Form 10-K) at 34; Ex. 15 (Tesla Feb. 26, 2015 Form 10-K) at 46; Ex. 12 (Tesla Jan. 29, 2010 Form S-1) at 75.

In exchange for delivering on the twin milestones corresponding to each tranche, Musk would receive per-tranche option grants. Ex. 10 (Dec. 12, 2017 Board Minutes) at TESLA_269. The Committee proposed, and Musk agreed, that the size of each tranche would be a fixed number of shares, equal to 1% of Tesla's outstanding shares at the time of the grant, rather than 1% of Tesla's fully diluted shares at the time of any vesting. Ex. 9 (Nov. 16, 2017 Board Minutes) at TESLA_268; Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 18. Thus, Musk (rather than the stockholders) would bear the cost of dilution caused by the inevitable increase in Tesla's share count. *Id*. (noting that dilution of Musk's award is certain to occur but that the extent of the dilution cannot be predicted). Not taking into account the diminishing effect of that inevitable dilution, the maximum value Musk could receive—if Tesla reached a valuation of $650 billion, all milestones are met, and all tranches paid out—would be $55.8 billion. *Id*.

As with the 2012 Performance Award, Musk would forfeit any options that did not vest within ten years. And the parties agreed that no options would vest unless, at the time the relevant milestones are met, Musk is serving either as the CEO or as both the Executive Chairman and the Chief Product Officer, with the CEO reporting directly to him. *Id.* at 12-13.

In December, the full board, excluding Elon and Kimbal Musk, met to consider the key terms of the contemplated performance award. Ex. 10 (Dec. 12,

2017 Board Minutes) at TESLA_269. Compensia advised the board of several unusually stockholder-friendly features of the plan that distinguished it from almost all other CEO pay packages. First, the contemplated award did not provide for any time-based vesting, salary, or cash bonus. *Id.* at TESLA_270. To the contrary, the proposed plan provided for no guaranteed compensation at all and conditioned Musk's compensation entirely on the achievement of unprecedented market capitalization, revenue, and profit goals. *Id.* Thus, if Tesla does not perform extraordinarily well, Musk would receive no compensation at all. Second, unlike many CEO pay packages, the contemplated award did not provide for automatic vesting of all unearned options upon a change in control of Tesla. Third, the contemplated award required Musk to hold any shares he acquired as a result of exercising vested options for three to five years. *Id.* By restricting Musk's ability to sell his shares for an extended time after vesting, this holding period was designed to align his incentives with Tesla's long-term success. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 10. Compensia concluded that the contemplated award was therefore "unusually closely aligned with shareholder interests." Ex. 10 (Dec. 12, 2017 Board Minutes) at TESLA_270.

In negotiating the remaining open terms of the award, the Committee secured two more concessions from Musk. Ex. 11 (Jan. 21, 2018 Board Minutes) at TESLA_274-75. First, Musk agreed to accept a five-year post-exercise holding period for shares he acquired by exercising vesting options, the longest period proposed. *Id.* Second, Musk agreed that the milestones would be adjusted higher

if the company made acquisitions material to the achievement of any milestones. *Id*. This provision ensured that Musk could be credited with a milestone target only if it had been met through organic growth, thus eliminating the possibility that Musk could rely on acquisitions to trigger any compensation. *Id.* Vested options would also be subject to a clawback if Tesla were to restate its financial statements and the options would not have qualified for vesting on the basis of the restatements. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 13.

In January, the board (again excluding Elon and Kimbal Musk) met to consider the potential award as it had been finally negotiated. Ex. 11 (Jan. 21, 2018 Board Minutes) at TESLA_274. After discussion with its advisors, the board determined that the contemplated award powerfully aligned Musk's interests with those of Tesla's stockholders and created the greatest likelihood that Musk would lead the company through the next stages of its ambitious strategic plan. *Id.* at TESLA_275.

The board approved the award on the basis of these conclusions. *Id.* It also conditioned implementation of the award on approval by a majority of disinterested voting shares. *Id.* at TESLA_277-78.

D. Stockholder approval of the 2018 Performance Award

The 2018 Performance Award was subject to the approval of Tesla's stockholders under the NASDAQ rules, Tesla's bylaws, and the Tesla board's resolutions approving the award. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 23. Tesla disclosed the 2018 Performance Award in a proxy filing with the SEC before

submitting the award to a vote of its stockholders at a special meeting in March 2018. *See* Ex. 18 (Tesla Feb. 8, 2018 Proxy). The proxy statement alerted Tesla stockholders that a failure to vote on the option grant would not be treated the same as a "no" vote (as a failure to vote is treated when the action voted upon is a merger or other fundamental corporate change) but would instead be treated as having no effect on the outcome of the vote: "If . . . you fail to vote, it will have no effect on the [2018 Performance Award], assuming a quorum is present." *Id.* at 23.

At the special meeting, 81% of voting shares and 80% of shares present and entitled to vote were voted in favor of the award, thus satisfying the standard for stockholder approval under the NASDAQ rules, Tesla's bylaws, and Tesla's board resolutions. Of the disinterested shares present at the meeting, 73% were voted in favor of the award, thus meeting the disinterested stockholder approval condition the Tesla board had imposed for implementation of the award. Ex. 19 (Tesla Mar. 21, 2018 Form 8-K) at 2.

E. Procedural history

After Tesla disclosed the 2018 Performance Award, plaintiff tendered a demand under 8 *Del. C.* § 220 to inspect corporate documents pertaining to the Award. Tesla provided plaintiff with corporate documents containing, among other things, the minutes of the Compensation Committee and board meetings in which the award had been considered, as well as materials provided to the Compensation Committee and the board by the Committee's outside advisors.

After Tesla's stockholders approved the 2018 Performance Award, plaintiff filed this action. The complaint asserts four claims: (1) a direct and derivative claim for breach of fiduciary duty against all of Tesla's directors except Musk for approving the 2018 Performance Award; (2) a direct and derivative claim for breach of fiduciary against Musk in his alleged capacity as Tesla's controlling stockholder for causing Tesla to enter into the 2018 Performance Award; (3) a derivative claim against the director defendants for waste; and (4) a derivative claim against Elon Musk for unjust enrichment. Plaintiff raises no challenge to the sufficiency of Tesla's disclosures regarding the 2018 Performance Award.

ARGUMENT

The complaint fails to state a claim upon which relief can be granted because (1) the 2018 Performance Award was ratified by Tesla's stockholders and is not adequately alleged to be waste, and (2) the 2018 Performance Award is not adequately alleged to be unfair. Accordingly, the complaint fails to state a claim for breach of fiduciary duty or waste against Tesla's directors and Musk. And because a claim for unjust enrichment cannot be maintained in the absence of a viable breach of fiduciary duty claim, the complaint also fails to state a claim against Musk for unjust enrichment. *See Gamco Asset Mgmt. Inc.* v. *iHeartMedia Inc.*, 2016 WL 6892802, at *19 (Del. Ch. Nov. 23, 2016), *aff'd*, 172 A.3d 884 (Del. 2017).

I. The complaint fails to state a claim because the 2018 Performance Award was ratified by Tesla's stockholders and the complaint does not plead facts showing that it constituted waste

Under well-settled Delaware law, an option grant to directors or officers that has been ratified by the stockholders is subject to judicial challenge only on the ground that it constituted waste. *See Lewis* v. *Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997); *Michelson* v. *Duncan*, 407 A.2d 211, 214, 222 (Del. 1979); *Kerbs* v. *Cal. E. Airways*, 90 A.2d 652, 655-56 (Del. 1952). That rule applies to Tesla's 2018 Performance Award because Tesla's disinterested stockholders approved it in a fully informed vote.

With respect to non-extraordinary corporate actions (like those at issue in this lawsuit), the necessary voting threshold for stockholder approval is not a majority of the outstanding but rather a majority of the shares present and entitled to vote at the stockholder meeting. Section 216 of the Delaware General Corporation Law (titled "Quorum and required vote for stock corporations") prescribes the default requirements that a stockholder vote must meet to qualify as approval of the corporate action voted upon. Section 216(1) sets the default minimum for a quorum:

> (1) A majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders.

Section 216(2) sets the default minimum for the affirmative voting threshold:

> (2) In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders.

When a stockholder vote governed by § 216 meets these quorum and voting threshold requirements, the outcome is statutorily deemed to "be the act of the stockholders"—even though the number of shares voted in favor of the corporate action at issue may have been less than a majority of the outstanding shares entitled to vote. 8 *Del. C.* § 216.

The default quorum and voting threshold requirements of § 216 apply unless another provision of the DGCL dictates "the vote that shall be required for a

specified action" or a corporation's charter or bylaws specify different requirements. *Id*.

The stockholder vote on the 2018 Performance Award was governed by the default quorum and voting threshold requirements of § 216 because no other provision of the DGCL dictates "the vote that shall be required for" the issuance of options or other compensation to directors or officers, and Tesla's charter and bylaws did not specify different requirements. *See* Ex. 16 (Tesla Feb. 1, 2017 Form 8-K) (disclosing amended charter and bylaws). The stockholder vote, held at a special meeting, satisfied the requirements of § 216: (1) a majority of Tesla's outstanding shares entitled to vote were present at the meeting, and (2) a majority of the shares present at the meeting and entitled to vote were voted for the 2018 Performance Award. The stockholder vote therefore qualified as stockholder approval of the 2018 Performance Award.

The stockholder vote also constituted *ratification* of the 2018 Performance Award because it met the quorum and voting threshold requirements of § 216 even when considering only the disinterested shares: (1) a majority (64%) of Tesla's outstanding disinterested shares entitled to vote were present at the meeting, and (2) a majority (73%) of those disinterested shares were voted in favor of the award.[3] *See In re Investors Bancorp., Inc. S'holder Litig.*, 177 A.3d 1208, 1211

[3] 86,595,138 disinterested shares were present at the special meeting, Ex. 19 (Tesla Mar. 21, 2018 Form 8-K) at 2, out of 135,245,733 disinterested shares outstanding, ¶ 53. 63,014,339 of the disinterested shares present at the meeting were voted for the 2018 Performance Award.

(Del. 2017) ("Stated generally, stockholder ratification means a majority of fully informed, uncoerced, and disinterested stockholders approved board action . . . .").

Michelson v. *Duncan*, 407 A.2d 211 (Del. 1979), another option-grant case, confirms that the vote of Tesla's disinterested stockholders ratified the 2018 Performance Award. In *Michelson*, the Supreme Court upheld this Court's ruling that an option award to directors and officers had been validly ratified. *Id.* at 214. The court so held after finding (1) that a majority of shares represented at the meeting were voted in favor of the challenged grant, and (2) that the proxy statement was not materially deficient. *Id.* at 221 ("Of the 37,724,220 shares represented in person or by proxy at the 1977 meeting, 32,670,527 shares (about 87%) were voted in favor of the resolution, 2,444,172 shares (about 6%) were voted against, and the remaining 2,509,521 shares were not voted with respect to the resolution."); *id.* at 222 ("[I]t was not error . . . for management to fail to inform the shareholders of the items enumerated by [plaintiff].").

The *Michelson* court thus affirmed the vote as a valid ratification based on its finding that the vote met the statutory voting threshold applicable to stockholder action on an option grant. The court did not inquire into, or even mention, whether the vote met any other voting threshold.[4] In particular, the *Michelson* court did not address whether the number of shares voted in favor of the option grant constituted

[4] The *Michelson* court then reversed the trial court's grant of summary judgement, but only after affirming the holding on ratification, solely on the ground that the complaint had adequately pleaded a claim of waste. *Michelson*, 407 A.2d at 214.

a majority of the shares outstanding, as opposed to those present at the meeting. *See also Kerbs*, 90 A.2d at 655 (citing with approval *Rogers* v. *Hill*, 289 U.S. 582 (1933), in which the United States Supreme Court, like the *Michelson* court, found stockholder ratification of officer compensation based on the affirmative vote of a majority of shares present at a stockholder meeting).

Plaintiff here alleges that a majority of the disinterested shares *outstanding*, as opposed to a majority of the disinterested shares present at the meeting, were not voted in favor of the 2018 Performance Award—apparently in an attempt to show that the Award was not ratified by Tesla's stockholders. ¶¶ 54-55. That allegation is accurate but irrelevant. If ratification of an option grant required majority-outstanding approval, then (for example) *Michelson* could not have reached its holding on the basis of the facts before the court. But, as *Michelson* shows, a majority of disinterested shares outstanding is not the voting threshold required to ratify an option award. The relevant question instead is whether the grant was approved by a majority of the disinterested shares present at the meeting where the vote occurred. *See Michelson*, 407 A.2d at 221; 8 *Del. C.* § 216.

Although certain decisions have conditioned a finding of ratification on the affirmative vote of a majority of disinterested shares outstanding, *see, e.g.*, *Corwin* v. *KKR Fin. Hldgs., LLC*, 125 A.3d 304, 311 & n.24 (Del. 2015); *Gantler* v. *Stephens*, 2008 WL 401124, at *16 (Del. Ch. Feb. 14, 2008), *rev'd on other grounds*, 965 A.2d 695 (Del. 2009), those decisions have addressed ratification of corporate actions such as mergers and charter amendments, which are among the

handful of corporate actions that fundamentally alter the corporate contract. In recognition of the extraordinary nature of such actions, the DGCL, like the common law before it, requires that such actions be approved by the affirmative vote of a majority of shares outstanding, not merely a majority of those present at the meeting at which the vote is held. *See* 8 *Del. C.* §§ 242 (charter amendment); 251 (merger); 271 (sale of substantially all corporate assets); 275 (dissolution). The majority-outstanding rule has thus been applied to extraordinary transactions, but not to transactions, such as option grants, that do not fundamentally alter the corporate contract.

As this Court has explained, the majority-outstanding threshold required for ratification of these fundamental changes corresponds to the majority-outstanding requirement for stockholder approval imposed by the DGCL. In *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006), for example, then-Vice Chancellor Strine explained that the affirmative vote of a majority of the disinterested shares present at the meeting is not "sufficient proof of fairness to obviate a judicial examination" of a merger "[b]ecause under 8 *Del. C.* § 251, a vote of a 'majority of the outstanding stock of the corporation entitled to vote' is required for merger approval, and a failure to cast a ballot is a *de facto* no vote." *Id.* For that reason, the Chief Justice concluded, "giving ratification effect" to a merger vote "only if a majority of the disinterested shares outstanding were cast in favor of the transaction . . . coheres with § 251." *Id.*; *see also Gantler*, 2008 WL 401124, at *16 (citing *PNB* and applying the same reasoning to conclude

that giving ratification effect to a vote on a charter amendment is appropriate only if a majority of the disinterested shares outstanding were cast in favor of the amendment because that is the voting threshold § 242 requires for approval of a charter amendment).

Applying a majority-of-shares-present standard to ratification of option grants similarly "coheres" with § 216 and Delaware's option-grant case law. And the Delaware jurisprudence linking the voting threshold required for ratification of a particular corporate action to the statutory voting threshold required for approval of that action is consistent with the general rule. The American Law Institute's *Principles of Corporate Governance*, for example, provide that the voting threshold for approval by "disinterested shareholders" is a majority of disinterested shares voted, ALI Principles § 1.16, which corresponds to the only voting threshold the ALI Principles prescribe for approval by stockholders in general—a majority of shares voted, *id.* § 1.02(a).

Applying a majority-of-the-outstanding standard in the option-grant context, on the other hand, would *not* cohere with the statutory voting requirement and would also upend stockholder expectations, which flow from Delaware's statutory scheme and blackletter case law. Stockholders know (or are presumed to know) that under § 251, "not voting is the same as voting against"—and proxy disclosures remind stockholders of this fact. *See, e.g.*, *In re Del Monte Foods Co. S'holders Litig.*, 2011 WL 2535256, at *6 (Del. Ch. June 27, 2011); *see also PNB*, 2006 WL

2403999, at *15 ("[I]n the merger context . . . refusal to return a proxy (if informedly made) is more likely a passive dissent.").

By contrast, when the vote is governed by § 216, stockholders know (or are presumed to know) that a failure to vote is treated as exactly that—and thus will have no effect on the outcome. Reflecting this reality, the proxy statement that Tesla filed in advance of the vote on the 2018 Performance Award expressly disclosed to Tesla stockholders that "if . . . you fail to vote, it will have no effect on the [2018 Performance Award], assuming a quorum is present." Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 23.

Because the 2018 Performance Award was ratified by Tesla's stockholders, the complaint is subject to dismissal unless it states a claim for waste. *See Lewis*, 699 A.2d at 336; *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 136 (Del. Ch. 2009) (holding that to plead waste, complaint must allege "particularized facts that lead to a reasonable inference that the director defendants authorized an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration"). As the Delaware Supreme Court has explained, this "vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful." *Singh* v. *Attenborough*, 137 A.3d 151, 152 (Del. 2016).

Under the facts pleaded, the waste exception has no "real-world relevance" here either. Plaintiff alleges that Musk is "highly active in [Tesla's] management,"

plays "a key role in the design of all Tesla products," and has presided as Chairman, CEO, and Chief Product Architect over the massive growth in Tesla's market capitalization from $3.9 billion in 2012 to $52.4 billion in 2017. ¶¶ 10, 22, 24, 39. Those allegations alone preclude any reasonable inference that the 2018 Performance Award, which does not authorize the payment of any compensation at all unless Musk leads a near doubling of Tesla's present market capitalization, could be waste.

II. The complaint fails to state a claim because it does not plead facts showing that the 2018 Performance Award was unfair to Tesla

Regardless of whether the 2018 Performance Award was ratified by Tesla's stockholders, the complaint fails to state a claim on the merits. That is so because even assuming, for purposes of this threshold motion, that the entire fairness standard applies to the Award, the complaint does not plead facts supporting a reasonable inference that the Award was unfair.

"Delaware law is clear that even where a transaction between the controlling shareholder and the company is involved—such that entire fairness review is in play—plaintiff must make factual allegations about the transaction in the complaint that demonstrate the absence of fairness." *Monroe County Emps.' Ret. Sys.* v. *Carlson*, 2010 WL 2376890, at *2 (Del. Ch. June 7, 2010). "Simply put, a plaintiff who fails to do this has not stated a claim." *Id.* (dismissing a complaint challenging a transaction subject to entire fairness review).

"[F]airness has two basic aspects: fair dealing and fair price." *Weinberger* v. *UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983). The complaint here does not satisfy "plaintiff's duty to plead sufficient facts demonstrating the unfairness of the challenged [transaction]" because it does not plead facts supporting a reasonable inference that the 2018 Performance Award was the product of unfair dealing or carried an unfair price. *Id.* at 703.

No allegations of unfair dealing. The issue of fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." *Id.* at 711. The complaint does not allege that the process leading to the 2018 Performance Award was unfair in any of these respects.

To the contrary, the complaint—including the documents it incorporates—confirms that the process was fair. The pleadings establish that it was the Compensation Committee of Tesla's board, not Musk, that initiated consideration of a new CEO compensation package, and that it did so because Musk was nearing completion of the milestones set by the 2012 Performance Award. Ex. 1 (June 23, 2017 Comp. Committee Minutes) at TESLA_1; *cf. Weinberger*, 457 A.2d at 711 (finding unfair dealing where challenged transaction was "entirely initiated" by majority stockholder). The complaint likewise affirms that the Compensation Committee and other outside directors spent six months considering and negotiating the new compensation arrangement and met nine times before

ultimately approving the 2018 Performance Award. Exs. 1, 3, 5-11. Nowhere does the complaint allege that the Tesla board was rushed or pressured to complete its task by Musk or anyone else. *Cf. Weinberger*, 457 A.2d at 711 ("serious time constraints . . . set by" majority stockholder indicated unfair dealing). The complaint acknowledges that the Committee was assisted by an outside compensation consultant and outside counsel that it selected itself. Ex. 1 (June 23, 2017 Comp. Committee Minutes) at TESLA_2. And the complaint does not allege that those advisors provided directors with incorrect, biased, or inadequate information. *Weinberger*, 457 A.2d at 712 ("cursory preparation of . . . fairness opinion" by financial advisor indicated unfair dealing).

As for the structure of the Award, *i.e.*, its terms, the complaint shows that it was the Compensation Committee that decided (after polling Tesla's largest stockholders) to model the 2018 Performance Award on that of the 2012 Performance Award—based on its determination that the prior award had successfully incentivized Musk to generate massive gains in total stockholder returns. Ex. 5 (Aug. 1, 2017 Comp. Committee Minutes) at TESLA_130. And the complaint also shows that it was the Compensation Committee, with the assistance of its advisors, that selected extremely aggressive milestones for the 2018 Performance Award, including milestones requiring $50 billion in incremental market capitalization growth. Ex. 4 (July 7, 2017 Comp. Consultant Presentation) at TESLA_107-10; *Weinberger*, 457 A.2d at 711 (finding unfair dealing where "[t]he structure of the transaction . . . was [the majority stockholder's] doing"). In

the negotiations over the Award, Musk accepted the basic structure and milestones proposed by the Committee. Ex. 10 (Dec. 12, 2017 Board Minutes) at TESLA_269. And late in the process, the Committee obtained additional concessions from Musk—his agreement that milestones could be achieved only through organic growth, not through acquisitions, and his acceptance of a five-year post-exercise holding requirement for any shares he acquired by exercising his vested options. Ex. 11 (Jan. 21, 2018 Board Minutes) at TESLA_274-75.

Nor does the complaint allege that the approval of the Award by Tesla's directors and stockholders was obtained unfairly. The complaint does not allege that Musk threatened or coerced the directors into approving the Award, or that their approval of the Award was inadequately informed. And it does not allege that stockholders were coerced into voting for the Award, or that the stockholder vote on the Award was less than fully informed. *Cf. Weinberger*, 457 A.2d at 712 (finding unfair dealing where material information was withheld from stockholders).

Against all this, the complaint alleges only two supposed flaws in the board's process for considering a new CEO compensation arrangement: (1) that Compensation Committee Chairman Ehrenpreis "engaged in a series of private conversations with E. Musk about the compensation package" even though he was not independent of Musk; and (2) that "[a] number of Tesla senior executives . . . were present at the Compensation Committee and Board meetings concerning" the

new compensation package even though they were not independent of Musk. ¶ 33 & n.18.

Neither of those allegations comes close to supporting an inference of unfair dealing. As to Ehrenpreis's alleged "private conversations" with Musk, plaintiff manages only the bare assertion that the conversations happened. Not a word is pleaded as to the substance of the alleged conversations. And not a single fact is pleaded to show that the alleged conversations undermined the integrity of the process leading to the 2018 Performance Award, or why it would be inappropriate for the Chairman of the Compensation Committee to discuss a new compensation plan with the person it was designed to incentivize.

Similarly, the complaint is devoid of facts showing how the presence of "Tesla senior executives" at board or Committee meetings constituted unfair dealing. It is of course customary for management to assist directors in the course of performing their duties. Indeed, as just one example, it is unclear how appropriate revenue and profit targets for a performance-based pay package could ever be selected without input from Tesla's CFO. The DGCL specifically entitles directors to rely on management for such advice. 8 *Del. C.* § 141(e). Regardless, the complaint does not even allege any action by management at the meetings, much less action that rendered the new compensation package unfair to Tesla.

At bottom, plaintiff's criticisms of the board's process for considering a new compensation plan are just repackaged allegations that Tesla's directors and management are not independent of Musk—the very same allegations that plaintiff

relies on to invoke entire fairness review. But as Chancellor Allen explained when dismissing an entire fairness claim on the pleadings, "restatements" of allegations disputing the independence of the directors and those who advised them are not sufficient to plead unfairness. *See Solomon* v. *Pathe Commc'ns Corp.*, 1995 WL 250374, at *6 (Del. Ch. Apr. 21, 1995), *aff'd*, 672 A.2d 35, 38-40 (Del. 1996). That is because it "does not alone constitute a wrong" for a board to cause a company to enter into a transaction subject to entire fairness review, including a transaction with an alleged controlling stockholder. *Id.* Such transactions "are perfectly acceptable if they are entirely fair." *Monroe County*, 2010 WL 2376890, at *2. Therefore, "a plaintiff must do more than allege that a transaction is a self-interested one in order to state a claim." *Solomon*, 1995 WL 250374, at *6. A plaintiff must allege *additional* facts "which if true would render the transaction unfair." *Id.*

This complaint fails to do that. As shown above, all of the allegations the complaint makes about the process that resulted in the 2018 Performance Award confirm rather than belie its fairness.

No allegations of unfair price. The complaint is likewise devoid of allegations supporting a reasonable inference that the 2018 Performance Award is unfairly priced. That is unsurprising in light of the complaint's failure to plead any defects in the process leading to the Award. *See Monroe County*, 2010 WL 2376890, at *2 (explaining that "Delaware law focuses on fair dealing . . . primarily because a fair price is more likely to follow fair dealing").

Plaintiff attempts to show that the price of the 2018 Performance Award is unfair by alleging that the "sheer size" of its potential payout is "staggering" and emphasizing that the unprecedented maximum potential payout is more than $50 billion. ¶¶ 37-38. But the complaint skips over the key terms of the Award so egregiously that it might as well be attacking a different agreement. While plaintiff rails against the maximum possible payout under the Award, he ignores the central fact that all of the award is contingent and none of it guaranteed; that Musk runs a very substantial risk of working as Tesla's CEO for no pay at all; that the Award has foreclosed to Musk all means of meeting pay thresholds except by overseeing massive organic growth and performance; and that under the terms of the Award, Musk will be paid his first dollar only if Tesla's stockholders have benefitted by stock appreciation and operational performance unprecedented in the company's history (and indeed in the industry's history).

Plaintiff's failure to take account of the "gets" as well as the "gives" is fatal to his complaint. Like the complaint Chancellor Chandler found insufficient to state a claim in *Monroe County*, the complaint here "makes no factual allegations about those [allegedly unfair] amounts to put them into perspective." *Monroe County*, 2010 WL 2376890, at *2. As the Chancellor held, whether a transaction's price is unfair depends on the relative value of the consideration exchanged. Standing alone, the price paid—even if very high—is necessarily inadequate to demonstrate the unfairness of the price. The value of what is to be received in return must also be taken into account. That is why Chancellor Chandler

dismissed a complaint challenging a corporation's purchase of services as unfair in *Monroe County*: because the complaint did "not allege that [the corporation] could obtain services at a better price elsewhere" or "anything about what [the] services are worth relative to the price [the corporation] paid," it "posit[ed] no basis for concluding that the . . . transactions were priced unfairly." *Id.*

The test is whether the complaint pleads facts showing that the price of the 2018 Performance Award is too high "relative" to the value of the services that Tesla is buying. *Monroe County*, 2010 WL 2376890, at *2. The complaint here fails that test. Plaintiff does not contest that any payout under the Award is contingent on Musk's achievement of massive increases in stockholder returns and extremely ambitious revenue and earnings targets. The complaint does not dispute the extraordinary difficulty of achieving those milestones. And the complaint does not allege that, assuming Musk meets these difficult goals, the fraction of the total increase in stockholder wealth that Tesla has agreed to pay Musk as compensation for driving that increase is excessive. Tesla disclosed that for each tranche of options Musk earned, he would realize approximately 0.8% of the total stockholder value that had to have been realized to earn that tranche. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 18. And each tranche requires $50 billion in market capitalization growth to vest. The basic arrangement Tesla struck was thus to pay Musk a 0.8% commission each time (within the Award's ten-year term) that he succeeds in leading Tesla to $50 billion in market cap growth *plus* unprecedented annual revenues or earnings—and to pay him exactly nothing if he fails.

The complaint attempts to plead unfair price by asserting the conclusion that the 2018 Performance Award is "completely out of line with peer CEO compensation arrangements" because it "dwarfs the pay packages of even the highest-paid CEOs of public companies." ¶¶ 40, 43. But it fails to adequately support this conclusion with factual allegations.

According to the complaint, the 2018 Performance Award exceeds the largest CEO pay package awarded in 2016 (which was approximately $98 million) because its "price" is at least $2.6 billion—the figure Tesla disclosed as the preliminary "aggregate fair value estimate" of the award. ¶¶ 37-38, 43. This allegation is inconsistent with and refuted by documents incorporated into the complaint.

To begin with, $2.6 billion is not the "price" of the 2018 Performance Award because it is not (as plaintiff seems to think) the present value of the 2018 Performance Award to Musk. Indeed, it is not even the present value of the cost Tesla will incur under the 2018 Performance Award. In the notes accompanying the disclosure of this figure, Tesla explained that the figure was a preliminary estimate of "the maximum stock-based compensation expense in respect of the CEO Performance Award that Tesla would ever recognize, *assuming the actual achievement of all performance milestones*." Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 35 (note 3 to Pro Forma Summary Compensation Table) (emphasis added). Tesla further cautioned that the "the preliminary aggregate fair value estimate [of $2.6 billion] does not necessarily correspond to the actual value of the CEO

Performance Award, if any, to Mr. Musk." *Id.* at 34 (note 1 to Pro Forma Summary Compensation Table). Tesla made this disclaimer for good reason: If the company does not *double* in market capitalization, then the value of the Award to Musk will be $0.

But even assuming the $2.6 billion could fairly be regarded as the "price" of the 2018 Performance Award, the complaint still fails to plead facts supporting its assertion that the Award is richer than any CEO compensation pay package awarded in 2016. ¶ 43 (showing table titled "The Largest CEO Pay Packages in 2016"). To do that, the complaint would have to contain factual allegations showing that those packages offered the CEO *less* compensation than the 2018 Performance Award in exchange for meeting performance standards as rigorous as those set by the 2018 Performance Award. That is, allegations of peer compensation are relevant to unfairness only if they support a reasonable inference that another corporation was paying its top executive less for the same or better performance. The complaint fails to do this because it makes zero allegations about the level of performance, if any, on which the listed CEO compensation packages were conditioned.

What's more, documents incorporated into the complaint confirm that the performance standards set by the 2018 Performance Award are far more rigorous than those imposed by any other CEO compensation package. The table on which plaintiff relies is drawn from a presentation made to Tesla's Compensation Committee by its outside compensation consultant, Compensia. ¶ 43 (citing Ex. 4

(July 7, 2017 Comp. Consultant Presentation) at TESLA_116). In the very same presentation, Compensia stated, "[b]ased on our review of market practices, this award will provide a larger compensation opportunity to the CEO than we have observed in the market, *but will be tied to performance goals that appear more challenging than any others we have observed (e.g., entire multiples of the current market cap will be required to earn the award)*." *Id*. at TESLA_106 (quoted in ¶ 42) (emphasis added).

The complaint establishes, furthermore, that Compensia's view of the 2018 Performance Award was shared by Semler Brossy, another outside compensation consultant the Compensation Committee considered retaining. According to the complaint, that firm also told the Committee that no other CEO compensation packages required performance goals as rigorous as those the Committee was considering: "What others consider highly leveraged plan designs with very aggressive performance requirements will not meet the standard that you are considering. The closest comparison will be the grant you made in 2012." ¶ 40 (quoting Ex. 2 (June 23, 2017 Comp. Consultant Presentation) at TESLA_14).[5] Thus, not one, but two outside compensation consultants concluded that the 2018 Performance Award is contingent on the achievement of performance requirements of unprecedented difficulty.

[5] In what appears to be a typographical error, the complaint cites TESLA_114 instead of TESLA_14 for this quotation.

Plaintiff disputes none of that. All his complaint does is broadly assert that the 2018 Performance Award provides bigger payout *potential* than other CEO pay packages. The complaint thus points to the pay arrangements of Apple Inc. and Oracle Corp., apparently to suggest that Tesla should follow a more familiar path. ¶ 44. But Delaware's enabling corporate law has never required companies to play follow-the-leader and never has (and should not) discourage innovation in governance. That principle holds good with special force here, because the disclosed terms of the Apple and Oracle CEO pay packages are significantly less stockholder-friendly than those of the 2018 Performance Award.

Plaintiff asserts that the grant of one million restricted stock units Apple awarded its CEO, Tim Cook, in 2011—allegedly valued at nearly $400 million—was "modest" compared to the 2018 Performance Award. ¶ 44 & n.21. But that conclusion is not—and cannot be—supported by factual allegations showing that Apple's 2011 award was contingent on the achievement of any performance goals, much less performance goals comparable to those of the 2018 Performance Award. In direct contrast to the 2018 Performance Award, vesting of the Apple grant was conditioned solely on Cook's continued employment with the company for ten years. To qualify for the grant, Cook was not required to create *any* stockholder value; all he had to do was show up. *See* Ex. 22 (Apple Inc. Jan. 9, 2012 Proxy) at 22. But Musk will get nothing under the 2018 Performance Award for simply remaining as CEO. He will receive payouts only if he presides over unprecedented growth in Tesla's market capitalization and financial performance. *See supra*

pp. 14-15. Put more directly, Musk will be paid only if Tesla's stockholders have already done extraordinarily well, whereas Cook gets paid no matter what. If anything, Apple's award shows just how unusually stockholder-friendly the 2018 Performance Award is.

Plaintiff similarly asserts that Larry Ellison's 2016 pay package from Oracle was "meager" compared to the 2018 Performance Award. ¶ 44. But the complaint does not plead any factual allegations suggesting Ellison—who was not even Oracle's CEO at the time—had to meet anything like the performance targets of the 2018 Performance Award to earn the full value of that package. Nor could it. Oracle's compensation package awarded Ellison stock units that vested as long as Oracle's revenue and cash flow grew at a relatively faster pace than its peers. Ex. 24 (Oracle Corp. Sept. 23, 2016 Proxy) at 39. Vesting was not conditioned on Oracle meeting *any* market capitalization or other stockholder-return metric. *Id.* Furthermore, Ellison was separately entitled to a cash bonus, calculated as a percentage of any growth in Oracle's pre-tax profits, without any absolute performance targets. *Id.* Finally, as part of the package, Ellison also received a substantial grant of time-vesting stock options—that is options that vested as long as he turned up for work. *Id.* By contrast, Musk receives zero compensation under the 2018 Performance Award unless he meets absolute performance targets that require massive increases in market capitalization *and* revenue and earnings figures.

The complaint's allegations regarding Apple and Oracle thus fail to support an inference that the 2018 Performance Award is unfairly priced. To the contrary, the allegations show the opposite—that unlike other CEO pay packages, the 2018 Performance Award is a remarkably stockholder-friendly arrangement that requires outsized performance before Tesla owes Musk even a single dollar.

For similar reasons, the complaint's allegation that the potential payout under the 2018 Performance Award is far larger than the potential payout under the 2012 Performance Award also fails to establish that the 2018 Performance Award is unfair. ¶ 41. The 2012 Performance Award's maximum payout was contingent on the achievement of operational goals plus a $40 billion increase in market cap. Ex. 18 (Tesla Feb. 8, 2018 Proxy) at 6. The 2018 Performance Award's maximum payout is contingent on the achievement of operational goals plus a nearly *$600 billion* increase in market cap. *Id*. at 9. The complaint does not allege—even conclusorily—that the potential payout under the 2018 Performance Award is disproportionate after taking into account the far greater amount of stockholder value that must be realized ($600 billion vs. $40 billion) for Musk to qualify for full vesting of the Award.

Finally, plaintiff alleges that the 2018 Performance Award is not merely excessive, but "*wholly unnecessary* to properly incentivize" Musk because his 22% stake in Tesla already gives him enough "financial incentive to continue to devote substantial time, energy and effort into growing and cultivating the success of Tesla." ¶ 45 (emphasis added). Plaintiff thus asserts that the 2018 Performance

Award is unfair because it offers Musk even the possibility of pay for his services as CEO. *Id.* As ostensible support for this assertion, plaintiff alleges that Mark Zuckerberg of Facebook and Larry Page of Alphabet—each the "visionary" founder, CEO, and substantial stockholder of an enormously successful technology company (and both of whom, unlike Musk, wield voting control over their companies)—were paid annual compensation of only $1 in 2017. ¶ 46.

To begin with, the complaint does not allege that Musk ever indicated that he is willing "to continue to devote substantial time, energy and effort into growing and cultivating the success of Tesla" without any substantial compensation, much less for free.[6] ¶ 45. To the contrary, the complaint concedes that Musk has competing business ambitions to which he could choose to devote much of his time. ¶ 10. Specifically, the complaint acknowledges that Musk is the CEO and majority stockholder of SpaceX, a private company valued at more than $20 billion, and that his stake in SpaceX is worth roughly the same as his stake in Tesla. ¶ 10 n.2. The complaint does not—and could not—allege that either

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[6] To the contrary, Musk has made clear that amounts he may earn under the 2018 Performance Award are essential to advance his long-time philanthropic goal of facilitating human habitation on Mars. *See* Katie Benner & Kenneth Chang, *SpaceX is now one of the world's most valuable privately held companies*, CNBC.com (July 27, 2017), available at https://www.cnbc.com/2017/07/27/spacex-is-now-one-of-the-worlds-most-valuable-privately-held-companies.html (last accessed Aug. 30, 2018) (cited at ¶ 10 n.1); Andrew Ross Sorkin, *Tesla's Elon Musk May Have Boldest Pay Plan in Corporate History*, NYTimes (Jan. 23, 2018), available at https://www.nytimes.com/2018/01/23/business/dealbook/tesla-elon-musk-pay.html (last accessed Aug. 30, 2018).

Zuckerberg or Page is also a CEO or substantial stockholder in another multi-billion dollar company. Nor does the complaint challenge the Compensation Committee's determination that Musk's role at SpaceX made it especially important to incentivize him to spend his time and energy on growing Tesla.

Moreover, the complaint fails to plead facts to show that $1 is anything like the market rate for "visionary" tech CEOs. The complaint does not and cannot allege that Facebook or Alphabet had sufficient bargaining power to impose such meager salaries on Zuckerberg and Page. As the companies' compensation disclosures show, Zuckerberg's salary was fixed at $1 per year at his request and Page's salary was set at $1 only after he declined Google's offer of a "market-competitive" salary. Ex. 23 (Facebook, Inc. Apr. 13, 2018 Proxy) at 22; Ex. 21 (Alphabet Inc. Apr. 27, 2018 Proxy) at 39.

Boiled down, plaintiff's complaint is that the potential payout under the 2018 Performance Award is just too big. But the fact that the 2018 Performance Award is unusual in the size of its potential payout does not render it unfair. The Award is equally unusual in requiring the CEO to create immense stockholder value before he can qualify for any compensation at all. The complaint pleads no facts to show that the size of the maximum potential payout is unfair in light of what the corporation would be receiving in exchange—an unprecedented increase in corporate and stockholder wealth, and no obligation to pay Musk anything until that increase is actually realized. The plan is bold but it is balanced, and—what matters for this motion—the complaint does not plead facts showing otherwise.

This failure is decisive. A contract that deviates from the norm is not necessarily, or even likely, unfair. The 2018 Performance Award is proof of that, as the complaint itself shows.

CONCLUSION

For the foregoing reasons, plaintiff's complaint should be dismissed with prejudice.

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CERTIFICATE OF SERVICE

I, Garrett B. Moritz, hereby certify that on September 7, 2018, I caused a true and correct copy of the *PUBLIC VERSION of Defendants' Opening Brief in Support of Their Motion to Dismiss the Complaint* to be served through File & Serve*Xpress* on the following counsel of record:

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