

CLIENT ALERT

Navigating Compensation Governance

Delaware Court Rejects Musk's Pay Package for Second Time

A Delaware Court has rejected Tesla's attempt to reinstate Elon Musk's court-rescinded options despite Tesla's shareholders "ratification" of the options.

Tesla and Musk could appeal the latest court decision or the earlier decision which initially struck down the Musk option grant.

Separately, the Court approved record-setting attorney fees in the amount of \$345 million, down from the initial fee request of \$5.6 billion.

Background

The saga of Elon Musk's option mega-grant continues. Shareholders first approved the multi-billion-dollar option grant in 2018. A Delaware court judge rescinded the grant on January 30, 2024, followed by a shareholder vote ratifying the rescinded option grant on June 13, 2024. On June 30, 2024, Tesla filed a motion with the Delaware court seeking reinstatement of the option grant on the basis of this shareholder ratification. On December 2, 2024, the Delaware court rejected Tesla's motion and let stand its decision to rescind the grant.

Against this backdrop, Tesla's market capitalization has increased from approximately \$50 billion to an extraordinary \$1 trillion+ over the same time period. This increase in market capitalization has driven the in-the-money value of these options to approximately \$100 billion!

Tesla Sought Reinstatement of Rescinded Options Through Novel Legal Gambit

After the January 2024 court decision rescinding Musk's option grants, Tesla executed what appears to be a novel legal strategy with the goal of persuading the Delaware court to reverse its decision. This strategy was premised on the legal theory that a post-judgment shareholder ratification of the Musk options would "cure" wrongs found by the Delaware court in connection with the grant of the options (including disclosure deficiencies, procedural deficiencies and breaches of fiduciary duty). In its proxy disclosure to shareholders, Tesla contended that the curing of these wrongs through shareholder ratification would result in the reinstatement of Musk's options. In addition, Tesla contended that the restoration of the option grants would undermine the rationale supporting plaintiffs' attorney's \$5 billion+ fee request and would justify a substantial reduction by the Court of such requested fees.

On June 13, 2024, 76% of Tesla shareholders approved the ratification of the Musk options.

On June 28, 2024, Tesla petitioned the Delaware Court to reverse its decision to rescind the Musk grants.

Delaware Court Rejects Tesla's Attempt to Reinstate Musk's Grants

On December 2, 2024, the Delaware court minced no words in its wholesale rejection of Tesla's motion to reverse the court's decision rescinding Musk's option grants. At the outset of its decision, the court acknowledges that "the large and talented group of defense firms got creative with the ratification argument." The pleasantries ended there with the court finding that defense counsels' "unprecedented theories" underlying the ratification argument "go against multiple strains of settled law." In particular, the court noted that counsels' theories were defective in the following ways:

- The defendants have no procedural ground for flipping the outcome of an adverse post-trial decision based on evidence they created after trial and noting that "[w]ere the court to condone the practice of allowing defeated parties to create new facts for the purpose of revising judgments, lawsuits would become interminable".
- Common-law ratification is an affirmative defense that must be timely raised, which means that, at a minimum, it cannot be raised for the first time after the decision.
- What the defendants call "common law ratification" has no basis in the common law, a stockholder vote standing alone cannot ratify a conflicted-controller transaction.
- Even if a stockholder vote could have a ratifying effect, it could not do so here due to multiple, material misstatements in the proxy statement seeking shareholder ratification.

The court noted that each of these defects standing alone defeats Tesla's motion to reverse the court's prior holding.

Tesla has already indicated that it will appeal the court's decision to the Delaware Supreme Court. When the appeal will be heard, and a decision rendered is not known at this time.

Delaware Court Approves Unprecedented Attorney Fees of \$345 Million

The Delaware Court also ruled on plaintiffs' counsel fee request. In an epic display of understatement, the court noted the following:

"The plaintiff's attorneys asked for \$5.6 billion in freely tradeable Tesla shares. In a case about excessive compensation, that was a bold ask."

The court found the methodology used to calculate the requested fees was "sound" (i.e., based on a percentage of the "value of the benefit achieved" by counsel i.e., \$56 billion) but would result in an unjustifiable "windfall" for plaintiffs' counsel. As suggested by defense counsel, the court determined that the value of the benefit achieved should reflect the reversal of the accounting expense associated with the rescission of Musk's options, which equaled the options' grant date fair value of \$2.3 billion. The court then applied a "conservative" 15% fee percentage to arrive at a fee award of \$345 million, which the court opined was "an appropriate sum to reward a total victory."

The fee award is a record by a Delaware court.

Tesla may pay the approved attorney fees in either stock or cash.

Meridian comments. Many legal observers predicted the Delaware court's decision to rebuff Tesla's attempt to reinstate Musk's options given the unprecedented nature of Tesla's legal gambit. The decision itself does not cover any new ground on corporate governance relative to the setting and approval of executive compensation. Further, as we noted in an earlier Client Update,¹ the initial decision rescinding the Musk option grant does **not** have widespread application to corporate board pay decisions, due to the relatively unique fact pattern underlying the Musk case. The cornerstone of the case was Musk's status as a "controlling shareholder." Only a handful of public company CEOs could plausibly be labeled a controlling shareholder under the court's analysis. However, the court's decision serves as an important reminder that Boards and compensation committees should maintain sound procedures and practices when developing executive pay packages.

Early opinion among legal writers is that the Delaware Supreme Court is unlikely to overturn the lower court's decision on the rescission of Musk's option grants. If that turns out to be the case, then the Tesla board could approve a replacement equity grant with a value approximating the current in-the-money value of the rescinded option grants (i.e., \$100 billion). However, unlike the 2018 option grants, the Board could conclude that the replacement grant should be subject solely to time-based vesting since Tesla achieved and exceeded the performance goals under the rescinded grant.

Without regard to the merits of the Delaware Court's initial decision to rescind Musk's grants, the facts and circumstances surrounding the option grant are likely to confound a non-legal observer as to how the grant harmed shareholders. Shareholders clearly understood the economics of the option grant at the time of its approval. The supposed conflicted and controlled board and compensation committee did not approve a sweetheart grant. Tesla could have granted Mr. Musk a mega grant of time-based restricted stock with a relatively short vesting period (and precedent exists for such grants at other public companies). Instead, Tesla's board and compensation committee approved a grant with fantastical and unprecedented performance goals that at the time of grant had an extremely low probability of achievement. The fact that these performance goals were achieved and exceeded does not demonstrate that such goals were not requiring at the time they were set.

The [Client Update](#) is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-347-2524 or dkalfen@meridiancp.com.

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¹ See Meridian Client Update [Delaware Court Strikes Down Musk's \\$56 Billion Pay Package](#), February 16, 2024