

## CLIENT ALERT

### Navigating Compensation Governance

## Tesla Attempts to Reinstate Musk Option Grant Through Shareholder Ratification

As has been widely reported, in January 2024 a Delaware Court rescinded Tesla's 2018 option grant to Elon Musk, which at the time was worth \$56 billion.

Tesla has struck back and is attempting to reinstate the court-rescinded grant by asking shareholders to "ratify" the option grant.

Tesla acknowledges the uncertainty of this legal strategy.

### A Refresher on the Delaware Court Decision to Rescind Musk's Option Grant

In 2018, Tesla granted to Elon Musk stock options to purchase shares roughly equal to 12% of Tesla's then outstanding shares subject to the achievement of certain financial and market capitalization goals. The grant was approved by shareholders in a binding vote. In 2023, the options fully vested with an approximate in-the-money value of \$56 billion, which represented approximately 10% of the increase in Tesla's market capitalization from the date of grant.

A Tesla shareholder filed a derivative shareholder suit in Delaware Court claiming that Musk and Tesla (and its Board and Compensation Committee) breached their fiduciary duty by awarding the stock options to Musk and asked the court to rescind the grant.

Based on an uncommon set of facts and circumstances, the Delaware Court determined that the grant of Musk's stock options should be evaluated under the "entire fairness standard" and that Tesla and Musk failed to show the grant met this standard based on the following:

- Musk's status as a "controlling shareholder" changed the standard of review from the **business judgment rule** to the **entire fairness standard** and shifted the burden of proof from plaintiff to Tesla and Musk.
- Generally, approval of an option grant by "fully informed" shareholders would shift the burden of proof back to plaintiff and change the legal standard of review to the business judgment rule. However, the Delaware Court found that Tesla's shareholders were **not** fully informed about the stock option grant at the time they approved the grant. Therefore, the burden of proving the stock option grant met the **entire fairness standard** remained with Tesla and Musk.

- This then required Tesla and Musk to establish the entire fairness of the grant. To do so, the Delaware Court required Tesla and Musk to show (i) “fair dealing” in the determination of the stock option grant and (ii) “fair price” of the grant. The Delaware Court held that Tesla and Musk failed to meet either requirement.
- As a result, the Delaware Court determined that Tesla and Musk **breached their fiduciary duty** by granting the stock option and that the appropriate remedy for such breach was the **full rescission** of Musk’s stock option grant.

As described below, Tesla’s 2024 proxy includes a proposal requesting shareholders ratify the 2018 option grant. *Noted several times within the 27-page proposal, Tesla disclosed that the company and Musk intend to appeal the Delaware Court’s decision.*

## Tesla Seeks Shareholder Ratification of Musk’s 2018 Option Grant

In its 2024 preliminary proxy, Tesla is requesting shareholders ratify Musk’s 2018 option grant. To address the Delaware Court’s findings that shareholders were not fully informed about material aspects of the option grant prior to the 2018 vote, Tesla’s 2024 preliminary proxy included beefed up disclosures on the following topics:

- Overview of 2018 process used to determine and approve the Musk grant.
- Rationale of Tesla’s board in approving the Musk grant.

The Delaware Court also found that Musk’s personal and professional relationships with the Board compromised the Board’s and the Compensation Committee’s independence in the determination of Musk’s 2018 option grant, which is noted in Tesla’s 2024 preliminary proxy. However, beyond noting this finding, Tesla does not address this matter in its ratification proposal.

Tesla believes that shareholder ratification of the 2018 option grant would have the following implications:

- Any wrongs found by the Delaware Court in connection with the 2018 Musk grant would be cured (including disclosure deficiencies, procedural deficiencies and breaches of fiduciary duty)
- The Court-rescinded 2018 option grant to Musk would be restored
- The restoration of the 2018 grant would undermine the rationale supporting plaintiff’s attorney’s \$5 billion fee request and would justify a substantial reduction by the Court of such requested fees

Tesla notes that the proposed ratification may be subject to legal challenge and that it could not predict with “certainty” the treatment of the ratification under Delaware law.

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Meridian will continue to monitor and report on developments in this matter.

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](mailto:dkalfen@meridiancp.com).

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