

MUSK: FEARED OR LOVED? DELAWARE CHANCERY COURT'S CONTROLLING SHAREHOLDER DOCTRINE AND THE EXPANSION OF JUDICIAL INQUIRY INTO DIRECTORIAL DECISION MAKING

SAM ELLIS

I. Introduction

In Delaware, there is no answer to whether a defendant's "soft power alone, anchored in historical and commercial ties" can support a controlling shareholder determination imposing fiduciary duties.¹

Elon Musk has been a prominent star in recent years, specifically as Tesla's CEO. While Musk's tweets have been a focal point of his media attention, his dealings with Tesla, Inc. have grabbed the attention of minority shareholders and the Delaware Chancery Court. This article focuses on two cases against Musk and Tesla's board of directors that raise interesting questions that will shape corporate law in the United States. Notably, in April this year, the Chancery Court declared the debate over controlling shareholder status as an area of "unsettled" Delaware law.²

A. *In re Tesla Motors 1 & 2*

In Re Tesla Motors brings the questions of Elon Musk's controlling shareholder status to the forefront and highlights the unsettled nature of Delaware law's controlling shareholder doctrine.

On August 1, 2016, Tesla announced it had executed an agreement to acquire SolarCity Corporation in an "all-stock deal."³ Elon Musk sat on SolarCity's board of directors at the time of the transaction and was its largest shareholder.⁴ Musk and similarly interested parties⁵ excused themselves from the vote to achieve approval from a majority of disinterested shareholders.⁶ On November 17, 2016, Tesla stockholders approved the acquisition.⁷ Tesla's board of directors relied on this approval by the majority of disinterested shareholders and did not invoke a special committee to approve the acquisition.⁸ Soon after the transaction, Tesla shareholders brought seven claims, including one derivative claim and one direct claim against Musk for breach of fiduciary duty as Tesla's controlling stockholder for improperly using his control to orchestrate an unfair deal.⁹

The main focus of this case fell on whether Elon Musk is a controlling shareholder of Tesla.¹⁰ In Delaware, a controlling shareholder is defined as a shareholder that "owns a majority

¹ *In re Pattern Energy Grp. Inc. S'holders Litig.*, No. CV 2020-0357-MTZ, 2021 WL 1812674, at *38 (Del. Ch. May 6, 2021).

² *In re Tesla Motors, Inc. S'holder Litig.*, No. CV 12711-VCS, 2022 WL 1237185, at *2 (Del. Ch. Apr. 27, 2022) [hereinafter *In re Tesla Motors 2*] ("beckoning the Court to explore a wide range of interesting and arguably unsettled legal issues, including, among others, the contours and nuances of Delaware's controlling stockholder law").

³ *In re Tesla Motors, Inc. S'holder Litigation*, 2018 WL 1560293, at *10 (Del. Ch. Mar. 28, 2018) [hereinafter *In re Tesla Motors 1*].

⁴ *Id.* at *2.

⁵ Interested parties are those with connections to Tesla and SolarCity.

⁶ *In re Tesla Motors 1*, 2018 WL 1560293, at *10.

⁷ *Id.*

⁸ *Id.* at *17.

⁹ *Id.* at *11.

¹⁰ *Id.* at *12 ("Because I agree the Complaint pleads facts that allow reasonable inferences that Musk was a controlling stockholder and that Plaintiffs' claims against all Defendants are subject to entire fairness review, I begin and end my analysis of the motion to dismiss there.").

interest in or *exercises control* over the business affairs of the corporation.”¹¹ Given Musk only owned 22.1% of Tesla’s voting power, the question became whether Musk exercised control over the business affairs of Tesla.¹²

The Court acknowledged that 22.1% voting power was “relatively low” in the controlling shareholder context.¹³ Even so, the Court found that Musk was a controlling shareholder.¹⁴ The Court’s determination that a shareholder with substantially less than 50% voting power was controlling, while not unprecedented,¹⁵ was unusual at minimum, especially because the Delaware Court of Chancery had described a previous controlling shareholder determination of a shareholder with 35% of voting power as “its most aggressive finding that a minority block holder was a controlling stockholder.”¹⁶

On April 27, 2022, Chancellor Sights reviewed the “compelling trial evidence” to find that the Business Judgment Rule did not apply to Tesla’s SolarCity acquisition.¹⁷ Instead, Chancellor Sights applied the entire fairness standard and declared the acquisition was indeed entirely fair.¹⁸ Notably, the Court declined to decide whether Musk is a “controlling shareholder” and acknowledged that the debate remains an area of “unsettled law.”¹⁹

B. *Tornetta v. Musk*

The controlling shareholder determination’s importance is illustrated in *Tornetta* as Delaware courts continue to intrude upon business judgement by weaponizing the entire fairness standard.

Before Tesla’s remarkable growth over the past two years, Tesla’s board of directors approved a compensation package for Elon Musk coined “The 2018 Performance Award” (“the Award”).²⁰ Faced with the possibility Musk may direct his focus to other business ventures, such as SpaceX, Tesla’s board sought to keep Musk’s primary focus on Tesla.²¹ The Award consisted of a 10-year incentive plan that can award Musk stock options worth \$55.8 billion.²² The stock options would vest contingent upon “market capitalization and operational milestones.”²³ These milestones, however, were not just drops in the bucket; each market capitalization milestone required a \$50

¹¹ *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1113 (Del. 1994) (quoting *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. Supr. 1987)).

¹² *In re Tesla Motors 1*, 2018 WL 1560293, at *12.

¹³ *Id.* at *14.

¹⁴ *Id.* at *13 (Four factors informed the Court’s determination that Musk was a controlling shareholder of Tesla: Musk’s ability to influence the stockholder vote to effect significant change at Tesla, including the removal of Board members; (2) Musk’s influence over the Board as Tesla’s visionary, CEO and Chairman of the Board; (3) Musk’s strong connections with members of the Tesla Board and the fact that a majority of the Tesla Board was “interested,” as that term is defined in our law, in the Acquisition; and (4) Tesla’s and Musk’s acknowledgement of Musk’s control in its public filings.)

¹⁵ *In re Zhongpin Inc. S’holders Litig.*, No. CV 7393-VCN, 2014 WL 6735457, at *8 (Del. Ch. Nov. 26, 2014), *rev’d sub nom. In re Cornerstone Therapeutics Inc. S’holder Litig.*, 115 A.3d 1173 (Del. 2015) (holding that a shareholder with 17.3% of the voting power was a controlling shareholder).

¹⁶ *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013) (citing *In re Cysive, Inc. S’holders Litig.*, 836 A.2d 531, 551–52 (Del. Ch. 2003)).

¹⁷ *In re Tesla Motors 2*, 2022 WL 1237185, at *2.

¹⁸ *Id.* at *27.

¹⁹ *Id.* at *30 (“Again, I have chosen not to enter into the fray of this debate, as the outcome does not depend on whether Elon is or is not a controller (or a controlling stockholder, if that is different).”).

²⁰ *Tornetta v. Musk*, 250 A.3d 793, 796 (Del. Ch. 2019).

²¹ *Id.* at 803.

²² *Id.* at 797.

²³ *Id.* at 803.

billion increase in Tesla's market capitalization.²⁴ Under the board's initial Award proposal for shareholder approval, the first milestone would be doubling Tesla's market capitalization.²⁵ While the Award could result in a \$55.8 billion payday for Musk, it could also award him nothing.²⁶

Tesla's board of directors brought the Award to the shareholders and received a majority of disinterested shareholder approval of the Award.²⁷ Upon the board's disclosure of the Award's approval, the plaintiff, a minority shareholder, brought suit challenging the Award.²⁸ Courts typically review officer compensation with extreme judicial deference to the board of directors.²⁹ The Court proceeded with the understanding that Musk is a controlling shareholder of Tesla,³⁰ holding that while a majority of disinterested shareholders approved the Award, Musk failed the framework established in *Kahn v. M & F Worldwide Corp* ("MFW").³¹ The MFW framework requires *both* a vote by a majority of disinterested shareholders *and* an independent special committee of the board to deem a conflicted controller buyout worthy of the business judgment rule.³² The Court acknowledged that nothing in MFW suggests the Court's holding was to extend any further than controlling shareholder mergers.³³ Specifically, the holding and framework of MFW specify a merger or a "transformative transaction."³⁴ An executive compensation package does not readily appear to transform a corporation like a controlling shareholder merger. Nevertheless, the Court found nothing to limit the framework of MFW and expanded its reach into executive compensation decisions.³⁵ Without an independent special committee, Musk was not worthy of the business judgment rule but the entire fairness standard.³⁶

Following MFW, the Court explained that in the presence of a majority of disinterested shareholder approval, the burden to prove unfairness shifts to the plaintiff.³⁷ The Court found that the plaintiff "barely" cleared this bar and did not warrant dismissal at this stage.³⁸ Seemingly a win for the plaintiff shareholders, the Court evaluated the fairness of the Award at a general level and hinted that Musk might indeed prevail even under the entire fairness standard moving forward.³⁹ The Court highlighted that the Award is incentive-based.⁴⁰ Musk may not reach any milestones and thus would be awarded nothing, or may reach all of the milestones, in which case the Award would compensate Musk far more than any other officer in history. But the latter would mean that Tesla

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 804 ("If none of the tranches of options vest, Musk will earn nothing under the Award.").

²⁷ *Tornetta*, 250 A.3d at 797.

²⁸ *Id.* at 804–05 ("Plaintiff filed his Complaint in which he asserts four claims: (1) a direct and derivative claim for breach of fiduciary duty against Musk in his capacity as Tesla's controlling shareholder for causing Tesla to adopt the Award; (2) a direct and derivative claim for breach of fiduciary duty against the Director Defendants for approving the Award; (3) a derivative claim for unjust enrichment against Musk; and (4) a derivative claim for waste against the Director Defendants.").

²⁹ *Id.* at 805 ("A board's decision to grant executive compensation is usually entitled to great deference.").

³⁰ *Id.* at 798, n.5 (explaining that as Vice-Chancellor Slight was the presiding judge—the same judge who determined Musk to be a controlling shareholder in *In re Tesla*, the defendants would not challenge the determination at this stage.)

³¹ 88 A.3d 635 (Del. 2014), overruled on other grounds by *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

³² *Tornetta*, 250 A.3d at 810 (citing *M & F Worldwide Corp.*, 88 A.3d at 645).

³³ *Id.* at 811.

³⁴ *Id.* at 810.

³⁵ *Id.* at 811 ("I do agree with Defendants that nothing in MFW or its progeny would suggest the Supreme Court intended to extend the holding to other transactions involving controlling stockholders.").

³⁶ *Id.* at 810, 812.

³⁷ *Id.* at 797–98.

³⁸ *Tornetta*, 250 A.3d at 812.

³⁹ *Id.* at 813.

⁴⁰ *Id.*

would become one of the most valuable companies in the world.⁴¹

II. Discussion

These two cases highlight Delaware case law's disdain for instances where a party, specifically a controlling shareholder, is on both sides of a transaction.⁴² The idea of controlling shareholders in the eyes of the court is best articulated as "the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla."⁴³ Such a characterization is based on inherent fear on the part of seemingly independent directors and minority shareholders. Yet, these cases seem to center around an all-star quarterback rather than an 800-pound Gorilla. Elon Musk is the face of Tesla and has been a focal point of its success, and it is possible that he will leave or diminish his role.⁴⁴ Like fans of a football franchise whose all-star quarterback is pondering switching teams, Tesla and its shareholders need him to stay and lead Tesla to "victory." These two cases provide two questions moving forward: (1) do Elon Musk and Tesla, Inc. provide a basis for reevaluating the controlling shareholder determination?; and if not, (2) will these cases unnecessarily expand Supreme Court jurisprudence and create the wrong incentives for officer compensation and incentive-based compensation?

A. Is Elon Musk an 800-pound Gorilla or an All-Star Quarterback?

The court's disdain for controlling shareholders on both sides of transactions is warranted. However, Elon Musk's influence might not be based on fear by the shareholders but on admiration.⁴⁵ Should courts rethink the disdain for controlling shareholder transactions? Or can admiration, rather than fear, create the same instances where directors and investors alike do not act in the company's best interest? Either way, the trial in *In re Tesla motors 2* did not appear to shed light on Elon Musk's role at Tesla and his influence over Tesla's board and shareholders in the controlling shareholder determination. When upholding Musk's status as a controlling shareholder during motions for summary judgment, the court found Musk's position was "inherently coercive," which was enough to support the determination regardless of if the court finds *actual* coercion.⁴⁶ The court acknowledged that the "inherent coercion" doctrine is not without its critics.⁴⁷

Given Musk's dedication to Tesla, Inc., his financial investment in Tesla, Inc., and his relatively low voting power, the Court should address whether Musk is, in fact, an 800-pound gorilla or is an innovative leader who is attempting and seemingly succeeding to take Tesla "to the moon."⁴⁸ The Court could easily conclude that admiration is just as bad, if not worse than fear, and could

⁴¹ *Id.* ("Tesla will be one of the most valuable companies in the world and all stakeholders will have reaped the benefits of Musk's incentivized focus.").

⁴² See Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 2011 (2019).

⁴³ *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002).

⁴⁴ *In re Tesla Motors 2*, 2022 WL 1237185, at *30 (citing Matt Levine, *Elon Musk Never Wanted to be CEO*, Money Stuff, BLOOMBERG LAW (July 13, 2021), <https://news.bloomberglaw.com/banking-law/mattlevines-money-stuff-elon-musk-never-wanted-to-be-ceo> ("... what gives [Elon Musk] power over Tesla is that he is the CEO and product architect and visionary and social media manager, and it would die without him, or so he and the board and let's face it the shareholders think.")).

⁴⁵ Unless the fear is, as described in *Tornetta*, based in Musk's potential departure from the company.

⁴⁶ *In re Tesla Motors 2*, 2020 WL 553902, at *12.

⁴⁷ *Id.* at *6.

⁴⁸ @elonmusk, TWITTER (Apr. 16, 2021 8:37 PM), <https://twitter.com/elonmusk/status/1383233200885882885>.

blind directors and investors to breaches of duty by the admired. In any event, clarity is needed and needed quickly.

B. Does the Implementation of MFW go too far?

Assuming the Court upholds the finding that Elon Musk is a controlling shareholder, the question arises whether the Court's use of the *MFW* framework requires judges to "second-guess a business transaction that rational investors have approved."⁴⁹ While the Court did acknowledge that the compensation package in *Tornetta* could prevail under entire fairness by stripping away the business judgment rule, the Court seems to expand the holding of *MFW*, further complicating the Delaware jurisprudence of controlling shareholders.⁵⁰

The framework articulated by the *MFW* Court did not deal with officer compensation but instead a merger that would transform the nature of the corporation where a controlling shareholder is on both sides of the transaction.⁵¹ Furthermore, the *Tornetta* Court's analysis applied to "circumstances that will enable a controlled merger" to retain the business judgment rule.⁵² While the *MFW* framework did not suggest any limitations to such transactions, it did not create an expansive framework either.

Tesla's board of directors had a legitimate fear that Musk may leave the company or limit his role to pursue alternative projects. Thus, the board decided to offer Musk a compensation package that could award Musk \$55.8 billion, more than any officer in history. Still, it similarly had the potential to award him nothing. Tesla's board did not need to subject the Award to a majority of disinterested shareholders, but it did anyway. Such shareholders voted and approved the Award.

Officer compensation has been a bedrock form of directorial discretion, which the Delaware court gives extreme judicial deference.⁵³ Such historical deference could have played a part in dissuading the court from expanding the holding of *MFW*. The court in *Tornetta* seeks to uproot the decision of Tesla's board and shareholders without any direction from the Supreme Court of Delaware and against historic deference for such decisions.

III. Conclusion

The saga of Elon Musk is fascinating, from Joe Rogan⁵⁴ to Dodge Coin⁵⁵ and now to Delaware corporate law.⁵⁶ The *In re Tesla* and *Tornetta* decisions articulate a framework that could

⁴⁹ William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1308 (2001).

⁵⁰ *Berteau v. Glazek*, No. CV 2020-0873-PAF, 2021 WL 2711678, at *14 (Del. Ch. June 30, 2021) ("The [*Tornetta*] court did not opine on which controlling stockholder transactions might not require the dual protections of *MFW* to obtain a lesser degree of scrutiny than entire fairness.").

⁵¹ *Tornetta*, 250 A.3d. at 798.

⁵² *Id.* at 646.

⁵³ *Id.* at 796–97 ("A board of directors' decision to fix the compensation of the company's executive officers is about as work-a-day as board decisions get. It is a decision entitled to great judicial deference.").

⁵⁴ Tom Krisher, *Tesla shares fall after Elon Musk smokes weed on Joe Rogan's podcast*, GLOBAL NEWS (Sept. 8, 2018), <https://globalnews.ca/news/4435710/elon-musk-weed-tesla-shares-drop>.

⁵⁵ Diksha Madhok, *Dogecoin price soars more than 100% to new record after Elon Musk tweets*, CNN BUSINESS (Apr. 16, 2021), <https://www.cnn.com/2021/04/16/investing/dogecoin-price-elon-musk-int-hk/index.html>.

⁵⁶ While extremely fascinating, Musk's further involvement in Delaware Law through his current attempted Twitter acquisition; such analysis is out of the scope of this article.

prove dangerous to the incentives of directors that the Court has historically sought to protect.⁵⁷ Should shareholders with a “minority block” of voting power seek to minimize their influence to protect themselves from suit? Stay off social media? Refuse interviews? Keep *strictly* professional relations with board members and shareholders alike?⁵⁸ It seems that no matter the voting power, shareholders with minority blocks will be constantly evaluated by the court. Such scrutiny by courts could disincentivize positive influence, which can spark growth and innovation.

Should directorial boards prevent these minority block shareholders with influence from using their knowledge and leadership skills to attempt to grow the company? What is the limiting principle of the *MFV* framework? While based on sound logic and a passion for protecting investors, the Court has placed these questions in the minds of directorial boards, officers, and shareholders.

Given the Chancery Court’s expansion of the framework laid out in *MFV*, the Supreme Court of Delaware should address the unsettled controlling shareholder doctrine. The court in *Tornetta* may very well be correct that on the margin, utilizing the approval of a majority of disinterested shareholders and using an independent special committee will best serve and protect shareholders. However, Elon Musk and Tesla present interesting questions for the Supreme Court of Delaware to answer before expanding the judiciary’s role in decisions, given the Court’s utmost deference until recently.

⁵⁷ See Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 455 (2005) (Preserving the business judgment rule “encourage[s] directors to serve and take risks; avoid[es] judicial encroachment into business decisions; and preserv[es] the board’s central decision making role in corporate governance”).

⁵⁸ *In re Tesla Motors 2*, 2022 WL 1237185, at *30 (quoting Ann Lipton, *Will He or Won’t He?*, Law Professor Blogs Network (July 17, 2021), https://lawprofessors.typepad.com/business_law/2021/07/will-he-or-wont-he.html) (“may better incentivize boards to “be strict about cleansing mechanisms”) (internal quotes omitted).