



# Tesla Motors: The Evolution of Governance From Inception to IPO

By David F. Larcker and Brian Tayan

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## TESLA MOTORS

In June 2010, Tesla Motors raised over \$225 million in an initial public offering that valued the electric car manufacturer at \$2 billion. It was the first time a U.S. automobile company went public since Ford Motor in 1956.

The evolution of Tesla—first incorporated in 2003 by engineers Martin Eberhard and Marc Tarpinning—in some ways has been unique, given the nature of its business. Unlike many venture-backed companies, Tesla requires significant physical capital and plant and equipment for growth. Almost all aspects of its operations—from concept design and development to mass production—are capital intensive. As a result, Tesla has had to seek multiple rounds of external financing since its inception. In addition, the company's operations are highly complex. The development of an electric car requires expertise in battery technology, automobile design, manufacturing design, and supply chain management. Overseeing this level of complexity places significant demands on company leadership. Finally, the company is attempting to disrupt an established industry in which its competitors have considerable advantages in terms of size and position.

And yet like most companies, both private and public, Tesla has also faced its share of organizational challenges. Examples include difficulty in the early years developing a prototype with the desired technical specifications, production cost overruns, and unexpected leadership changes among management.<sup>1</sup> Together, these organizational and business model factors have had an impact in shaping the company's governance structure as it exists today.

## BOARD OF DIRECTORS

The size and composition of Tesla's board of directors has evolved to reflect the different stages of growth and changes in its investor base. Between 2004 and 2009, the company raised approximately \$200 million through six funding events. Each time that the company sought capital, a lead investor was granted a seat on the board of directors. For example, in 2004, Elon Musk contributed \$6.3 million out of a total \$7.5 million Series A funding event. Concurrent with this investment, Musk assumed chairmanship of the board, where he served alongside co-founders Eberhard and Tarpinning. Following Series B, C, and D, the venture capitalists who provided financing were added to the board. In Series E, Daimler AG made a strategic investment in Tesla, for which it received a directorship. In 2009, to satisfy regulatory requirements prior to an impending IPO, the company added its first fully independent director—Brad Buss, chief financial officer of Cypress Semiconductor. The company also established formal board committees for audit, compensation, and nominating and governance. Prominent Silicon Valley lawyer Larry Sonsini was added as non-director outside counsel (see Exhibit 1).

Despite these changes, however, influence over the firm has remained largely with Musk. Musk not only participated in the company's first round of financing but maintained a significant ownership position by continuing to invest in subsequent rounds. Even after the company's IPO in 2010, which diluted private investors, Musk continued to hold 36 percent of Tesla's outstanding stock. Musk used his control to weigh in on strategic and technological decisions. He led the company's financing

efforts, helping to determine who would participate and therefore the composition of the board itself. He successfully brought on his brother Kimbal Musk to serve as a director. Following internal disagreements, he was able to remove Eberhard as CEO and, after the brief appointment of two interim CEOs, assumed the position himself.

The company's board composition also reflects a transition from a fledgling organization to a formally managed public corporation. In the beginning, the company was focused almost entirely on survival. The three-person board comprising Musk, Eberhard, and Tarpinning in part reflects this. Subsequently, venture capitalists were brought on not only to provide financing but also to weigh in on strategy and operations. Board members Ehrenpreis, Gracias, and Jurvetson brought expertise in clean technology, material science, and financial operations. These skill sets enabled the company to verify its business model and add rigor to its internal processes. Later, as the company grew closer to full-scale production, it accepted a 10 percent strategic investment from Daimler AG. The addition of Herbert Kohler to the board, as a representative of Daimler and vice president of that company's Group Research and Advanced Engineering, reflected Tesla's need for further operational expertise as it ramped up production (see Exhibit 2).

*What we might expect:* As Tesla grows the composition of the board is likely to become more consistent with that of other publicly traded companies. After the venture capitalists that hold substantial equity positions sell down their investment, we would expect their representatives to step down from the board. They are likely to be replaced by more "conventional" public directors: active and retired CEOs, and other professionals with specific expertise in manufacturing, technology, financing, and law. As firms mature, different sets of skills are needed for the board of directors.

#### **ANTITAKEOVER PROTECTIONS AND OTHER RESTRICTIVE COVENANTS**

The company has adopted antitakeover protections that reflect its status as a relatively young technology company. At the time of Tesla's initial public offering, the company had several provisions in

place to reduce the likelihood of a hostile takeover.<sup>2</sup> These include a staggered board with three classes of directors, authorization to issue "blank check" preferred stock without shareholder approval, limitations on the ability of shareholders to call a special meeting, advance notice of shareholder proposals for business conducted at shareholder meetings, and power of the board to postpone or cancel previously scheduled shareholder meetings. Although such provisions might be viewed as indicative of management entrenchment, they might also serve a legitimate business purpose by granting Tesla time to commercialize its technology without the threat of early acquisition by a competitor.

Tesla has also agreed to restrictive covenants as part of its external financing agreements. For example, the company's financing agreement with Daimler grants that company favorable terms and conditions, including right of first refusal in case of a sale of Tesla and special contracts for production of parts. In addition, Musk has agreed not to transfer any of the shares beneficially owned by him to any other automobile manufacturer or to vote in favor of a proposed acquisition by an automobile manufacturer without Daimler's consent. A \$465 million loan facility by the U.S. Department of Energy also contains restrictive covenants. The 2009 loan facility provides that Tesla will be in default if Musk and certain of his affiliates sell down their ownership position by 35 percent prior to one year after completion of the company's new Model S (which the loan facility serves to finance).<sup>3</sup> Together, these covenants further reduce the likelihood of an unsolicited change in control.

*What we might expect:* Tesla might make no changes to the antitakeover protections. Antitakeover provisions enable the board and management to extract the highest price possible from a potential suitor (i.e., they can stop a takeover if company officials view the price as too low). However, as Tesla becomes more widely owned, shareholders might pressure the board to unwind some or all of these restrictions. This is especially true if shareholders believe that the adoption of these protections is not in their best interest.

## COMPENSATION

As might be expected with a new innovative company, executive compensation at Tesla is heavily skewed toward equity-based pay. In 2009, Musk was awarded \$24.1 million in compensation, comprising \$33,000 salary, \$23.9 million in options, and \$206,000 in other compensation and benefits.<sup>4</sup> This mix is not inconsistent with that awarded at other technology companies in Silicon Valley, particularly among companies whose shareholder base is dominated by a controlling CEO. Half of the stock option awards granted to Musk contain basic time-based vesting, with one quarter of those shares vesting immediately and the remainder vesting monthly. The other half of Musk's equity awards are performance-based stock options, with milestone vesting. One quarter of these shares vest upon successful completion of the engineering prototype for Model S; one quarter vest upon completion of the vehicle prototype for Model S; one quarter upon the first Model S production vehicle; and the final quarter upon completion of the ten thousandth Model S production vehicle. Milestone vesting is commonly used by companies whose future success is heavily reliant upon the successful introduction of new technology (see Exhibit 3).

*What we might expect:* As Tesla becomes a more mature company, it is likely to adopt executive compensation packages that are more conventional in structure. These might include a higher cash portion and lower equity portion. Tesla is also less likely to grant significant options with strategic milestone vesting once it has established commercial success. However, so long as Musk remains CEO, the mix of compensation might continue to skew heavily toward equity-linked rewards. That said, at some point, Musk and others will potentially desire to consume their personal wealth or diversify their investment portfolios. When this occurs, the company is likely to increase the cash portion of compensation, or allow Musk to engage in hedging or sales transactions.

## WHY THIS MATTERS

1. Many prominent experts in corporate governance advocate a set of best practices in terms of board structure, antitakeover protections,

and compensation. However, the case of Tesla demonstrates that governance is often company specific, based on the organization's current stage of development and operating needs. How well is this understood by those who examine and critique governance practices at specific corporations—including proxy advisory firms, the financial press, and other experts?

2. At Tesla, we see a pronounced change in the board of directors from inception to IPO. These changes seem consistent with the skills required as the company developed operationally and financially. What changes should be made in the future as Tesla continues to evolve as a public company? How will the board change over time in terms of structure, composition, and skills set?

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<sup>1</sup> The managerial challenges of Tesla are described in detail in: Michael V. Copeland, "Tesla's Wild Ride," *Fortune*, Jul. 21, 2008.

<sup>2</sup> This is fairly typical for IPO firms. See: Robert Daines and Michael Klausner. Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs. 17 *Journal of Law, Economics, & Organization* 83-120 (April 2001).

<sup>3</sup> Tesla Form S-1/A, Filed June 15, 2010 with the SEC. Tesla Form S-1/A, Filed June 15, 2010 with the SEC.

<sup>4</sup> *Ibid.*

David Larcker is the Morgan Stanley Director of the Center for Leadership Development and Research at the Stanford Graduate School of Business and senior faculty member at the Rock Center for Corporate Governance at Stanford University. Brian Tayan is a researcher with Stanford's Center for Leadership Development and Research. They are coauthors of the books *A Real Look at Real World Corporate Governance* and *Corporate Governance Matters*. The authors would like to thank Prital S. Kadakia, MBA 2012, whose research formed the basis of this material.

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## EXHIBIT 1 — TESLA: FUNDING EVENTS AND BOARD OF DIRECTORS

Series:	Series A	Series B	Series C	Series D	Series E	Series F
Year:	2004	2005	2006	2007	2008	2009
Amount:	\$7.5 million	\$13 million	\$40 million	\$45 million	\$40 million	\$50 million
Investors:	Elon Musk Compass	Elon Musk Compass Valor Equity	Elon Musk Capricorn Compass Draper Fisher Google JP Morgan Valor Equity VantagePoint	Elon Musk Capricorn Compass Draper Fisher JP Morgan Valor Equity VantagePoint Tech. Venture	Daimler	Daimler Al Wahada
Board:	Musk Eberhard Tarpenning	Musk Eberhard K. Musk Gracias (Valor) Tarpenning	Musk Eberhard Gracias (Valor) Jurvetson (Draper) Marver (Vantage) K. Musk Tarpenning	Musk Eberhard Ehrenpreis (Tech.) Gracias (Valor) Jurvetson (Draper) Marver (Vantage) K. Musk Tarpenning	Musk Ehrenpreis (Tech.) Gracias (Valor) Jurvetson (Draper) Kohler (Daimler) Marver (Vantage) K. Musk Sonsini (counsel)	Musk Buss (outsider) Al Darmaki (Wahada) Ehrenpreis (Tech.) Gracias (Valor) Jurvetson (Draper) Kohler (Daimler) K. Musk Sonsini (counsel)
Chairman:	Musk	Musk	Musk	Musk	Musk	Musk
Audit:	None	None	None	None	None	Buss Gracias Jurvetson
Comp:	None	None	None	None	None	Buss Ehrenpreis Gracias
Nom/Gov:	None	None	None	None	None	Buss Ehrenpreis Gracias

Sources: Funding events derived from: Tesla Form S-1/A, Filed June 15, 2010 with the SEC and <http://www.crunchbase.com/company/tesla-motors>; investors in each series might exclude certain individuals.

**EXHIBIT 2 — TESLA: BOARD OF DIRECTORS (2010)**

**H.E. Ahmed Saif Al Darmaki** has been a member of our Board of Directors since September 2009. Since September 1999, Mr. Al Darmaki has been Planning & Development Director of Abu Dhabi Water and Electricity Authority, which manages the generation, transmission and distribution of water and electricity in the Emirate of Abu Dhabi. Mr. Al Darmaki holds a B.S. in business administration and finance from United Arab Emirates University and an M.B.A. from the Zayed University. We believe that Mr. Al Darmaki possesses specific attributes that qualify him to serve as a member of our Board of Directors, including his experience with both international public and private companies and his experience in the energy sector.

**Brad W. Buss** has been a member of our Board of Directors since November 2009. Since August 2005, Mr. Buss has been Executive Vice President of Finance and Administration and Chief Financial Officer of Cypress Semiconductor Corporation, a semiconductor design and manufacturing company. Prior to joining Cypress, Mr. Buss served as Vice President of Finance at Altera Corp., a semiconductor design and manufacturing company, from March 2000 to March 2001 and from October 2001 to August 2005. From March 2001 to October 2001, Mr. Buss served as the Chief Financial Officer of Zaffire, Inc., a developer and manufacturer of optical networking equipment. Mr. Buss holds a B.S. in economics from McMaster University and an honors business administration degree, majoring in finance and accounting, from the University of Windsor. We believe that Mr. Buss possesses specific attributes that qualify him to serve as a member of our Board of Directors and to serve as chair of our audit committee, including his executive experience and his financial and accounting expertise with both public and private companies.

**Ira Ehrenpreis** has been a member of our Board of Directors since May 2007. Mr. Ehrenpreis has been with Technology Partners, a private equity firm, since 1996. He is presently a managing member of the firm and leads the Technology Partners' Cleantech practice. In the venture capital community, he serves on the Board of the National Venture Capital Association and the Western Association of Venture Capitalists and is the Co-Chairman of both the VCNetwork and the Young Venture Capital Association, two organizations comprising more than 1,000 venture capitalists. In the cleantech sector, he has served on several industry boards, including the American Council on Renewable Energy and the Cleantech Venture Network (Past Chairman of Advisory Board), and has been the Chairman of the Clean-Tech Investor Summit in 2005, 2006, 2007, 2008, 2009 and 2010. Mr. Ehrenpreis holds a B.A. from the University of California, Los Angeles and a J.D. and M.B.A. from Stanford University. We believe that Mr. Ehrenpreis possesses specific attributes that qualify him to serve as a member of our Board of Directors and serve as chair of our corporate governance committee and chair of our compensation committee, including his experience in the cleantech and venture capital industries.

**Antonio J. Gracias** has been a member of our Board of Directors since May 2007. Since 2003, Mr. Gracias has been Chief Executive Officer of Valor Management Corp., a venture capital firm. Mr. Gracias holds a joint B.S. and M.S. degree in international finance and economics from the Georgetown University School of Foreign Service and a J.D. from the University of Chicago Law School. We believe that Mr. Gracias possesses specific attributes that qualify him to serve as a member of our Board of Directors, including his management experience with a nationally recognized private equity firm and his operations management and supply chain optimization expertise.

**Stephen T. Jurvetson** has been a member of our Board of Directors since June 2009. Since 1995, Mr. Jurvetson has been a Managing Director of Draper Fisher Jurvetson, a venture capital firm. Mr. Jurvetson is a director of NeoPhotonics Corporation, Synthetic Genomics Inc. and Space Exploration Technologies Corporation, among others. Mr. Jurvetson holds B.S. and M.S. degrees in electrical engineering from Stanford University and an M.B.A. from the Stanford Business School. We believe that Mr. Jurvetson possesses specific attributes that qualify him to serve as a member of our Board of Directors, including his experience in the venture capital industry and his years of business and leadership experience.

**Herbert Kohler** has been a member of our Board of Directors since May 2009. Since 1976, Dr. Kohler has served in various positions at Daimler AG, or Daimler, an automobile manufacturer, most recently as Vice President of Group Research & Advanced Engineering e-drive & Future Mobility and Chief Environmental Officer since April 2009. In August 2006, Dr. Kohler was appointed head of Daimler's Group Research & Advanced Engineering Vehicle and Powertrain. From October 2000 to August 2006, Dr. Kohler served as vice president for Daimler's Body and Powertrain Research. Dr. Kohler holds a Diploma and Ph.D. in engineering from Stuttgart University. We believe that Dr. Kohler possesses specific attributes that qualify him to serve as a member of our Board of Directors, including his management experience with a multinational automobile manufacturer, his experience in advanced vehicle technologies and his general strategic and operational experience in the automobile industry.

**EXHIBIT 2 — CONTINUED**

**Kimbal Musk** has been a member of our Board of Directors since April 2004. Since June 2006, Mr. Musk has been Chief Executive Officer of OneRiot, Inc., an internet software company based in Boulder, Colorado. Since January 2004, Mr. Musk has been the owner of The Kitchen, a USA Today Top Ten restaurant. In November 1995, Mr. Musk co-founded Zip2 Corporation, a provider of enterprise software and services, which was acquired by Compaq in March 1999. Mr. Musk holds a B.Comm. in business from Queen's University and is a graduate of The French Culinary Institute in New York City. We believe that Mr. Musk possesses specific attributes that qualify him to serve as a member of our Board of Directors, including his experience with private technology companies and his business experience in retail and consumer markets.

Source: Tesla Form S-1/A, Filed June 15, 2010 with the SEC.

**EXHIBIT 3 — TESLA: EXECUTIVE COMPENSATION (2009)**

Name and Principal Position	Year	Salary	Option Awards (1)	All Other	Total
Elon Musk Chairman and CEO	2009	\$33,280	\$23,893,283	\$206,245 (2)	\$24,132,808
Deepak Ahuja CFO	2009	287,200	225,178	156,344 (3)	668,722
Jeffrey B. Straubel CTO	2009	192,922	540,832	-	733,754
John Walker VP, North America Sales	2009	106,650 (4)	272,725	14,900 (5)	394,275
Michael Donoughe (6) Former EVP, Engineering	2009	325,000	70,332	-	395,332
Jon Sobel (7) Former General Counsel	2009	88,558	436,360	-	524,918

(1) The amounts in this column represent the aggregate grant date fair value of the option awards computed in accordance with FASB Topic ASC 718.

(2) Includes reimbursement for filing fees in the amount of \$125,000 paid by Mr. Musk on behalf of the Elon Musk Revocable Trust dated July 22, 2003, or the Trust, in connection with a filing made under the Hart Scott-Rodino Antitrust Improvements Act of 1976, as amended, as a result of the acquisition of additional shares of our voting securities by the Trust as part of our Series E convertible preferred stock financing plus an additional tax gross-up amount of \$81,245.

(3) Includes reimbursement for relocation expenses in the amount of \$70,789 and reimbursement for temporary housing expenses in the amount of \$85,554.

(4) Mr. Walker joined us as our Vice President, North America Sales & Marketing in August 2009 and received a prorated base salary based on an annual salary of \$250,000. Amount includes sales commissions paid to Mr. Walker in the amount of \$12,900.

(5) Includes reimbursement for temporary housing and incidental expenses in the amount of \$14,900.

(6) Mr. Donoughe resigned as our Executive Vice President, Vehicle Engineering and Manufacturing in September 2009, although he remained employed on a leave of absence basis through December 31, 2009.

(7) Mr. Sobel joined us as our General Counsel in August 2009 and resigned in December 2009 and received a prorated base salary based on an annual base salary of \$300,000.

Source: Tesla Form S-1/A, Filed June 15, 2010 with the SEC.