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MERCER CAPITAL

Tesla Walks the Entirely Fair Line with SolarCity

Evaluating Fairness of the Tesla Motors, Inc. and SolarCity Corporation Merger

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JOINT PROXY STATEMENT/PROSPECTUS



October 12, 2016

MERGER PROPOSAL—YOUR VOTE IS VERY IMPORTANT
EXPLANATORY NOTE

On July 31, 2016, Tesla Motors, Inc. ("**Tesla**"), SolarCity Corporation ("**SolarCity**") and D Subsidiary, Inc., a wholly owned subsidiary of Tesla ("**Merger Sub**"), entered into an Agreement and Plan of Merger (the "**Merger Agreement**"). Pursuant to the terms of and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into SolarCity (the "**Merger**"), with SolarCity surviving the Merger as a wholly owned subsidiary of Tesla.

If the Merger is completed, SolarCity stockholders will have the right to receive 0.110 shares (the "**Exchange Ratio**") of Tesla Common Stock for each share of SolarCity Common Stock issued and outstanding (except shares held by SolarCity as treasury stock or shares owned by Tesla or Merger Sub), with cash paid in lieu of fractional shares. This Exchange Ratio is fixed and will not be adjusted to reflect stock price changes prior to the closing of the Merger. Based on the closing price of Tesla Common Stock on the NASDAQ Global Select Stock Market ("**NASDAQ**") on June 21, 2016, the last full trading day before the public announcement of Tesla's proposal to acquire SolarCity, the Exchange Ratio represents approximately \$24.16 in value for each share of SolarCity Common Stock. Based on the closing price of Tesla Common Stock on NASDAQ on October 10, 2016, the latest practicable date before the date of the enclosed joint proxy statement/prospectus, the Exchange Ratio represents approximately \$22.10 in value for each share of SolarCity Common Stock. Tesla stockholders will continue to own their existing shares of Tesla Common Stock. Tesla Common Stock is currently traded on NASDAQ under the symbol "TSLA" and SolarCity Common Stock is currently traded on NASDAQ under the symbol "SCTY." We urge you to obtain current market quotations of Tesla and SolarCity Common Stock.

Based on the estimated number of shares of SolarCity Common Stock outstanding on September 23, 2016, the record date for the special meetings, Tesla expects to issue approximately 11,080,333 shares of Tesla Common Stock to SolarCity stockholders in connection with the Merger, which would result in Tesla stockholders owning approximately 93.1% of the Combined Company and former SolarCity stockholders will own approximately 6.9% of the Combined Company upon completion of the Merger.

Tesla and SolarCity will each hold special meetings of their respective stockholders in connection with the proposed Merger.

Disclaimer

This short presentation is intended to discuss some of the fairness issues addressed by the Delaware Court of Chancery in its April 27, 2022, opinion re: Tesla Motors, Inc. Stockholder Litigation (C.A. No. 12711-VCS) arising from the November 2016 acquisition of SolarCity Corporation by Tesla Motors, Inc. In early 2017, the name of the company was shortened to Tesla, Inc.

A link to the ruling can be found [here](#) and a link to the joint proxy/prospectus dated October 12, 2016, can be found [here](#).

In addition, the presentation makes observations about the financial performance of both companies and the deal structure. Nothing in this this presentation should be construed to convey legal, accounting, investment or tax-related advice.

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- Values illiquid securities on behalf of companies, financial institutions, private equity and credit sponsors, high net worth individuals, benefit plan trustees, and government agencies;
- Provides advisory services including the issuance of fairness and solvency opinions related to M&A, divestitures, capital raises, buy-backs and other significant corporate transactions; and
- Provides buyer and seller representation in M&A transactions.

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The Lawsuits

Section 1

Tesla Stockholders Litigation

On July 31, 2016, the Board of Directors of Tesla Motors, Inc, (“Tesla” or “TSLA”) and SolarCity Corporation (“SolarCity” or “SCTY”) entered into a merger agreement in which Tesla would acquire SolarCity via a share exchange (“Acquisition”) that valued SolarCity at \$2.6 billion and would result in SolarCity owning about 6.9% of Tesla’s common shares upon consummation of the Acquisition.

Between September 1 and October 5, 2016, seven lawsuits that were later consolidated were filed in the Delaware Court of Chancery (“Court”) by stockholders of Tesla challenging the merger (“Litigation”). The plaintiffs alleged that:

- The Tesla Board breached its fiduciary duty of loyalty (but not care) in approving the acquisition;
- That Elon Musk (“Musk”) as a controlling shareholder was unjustly enriched (Musk owned approximately 22% of both Tesla and SolarCity); and
- The Acquisition constituted waste.

Each suit named members of the Tesla Board, and some named the merger sub, SolarCity, certain members of the SolarCity Board and Tesla advisors Evercore and Goldman Sachs.

By the time the trial commenced in 2021, Musk was the only director defendant because the other directors settled with the plaintiffs for \$60 million, which was covered by Tesla’s director & officer insurance policy. Depending upon how the claims were calculated, the plaintiffs sought damages up to \$13 billion.

Tesla Stockholders Litigation

Vice Chancellor Joseph R. Slight III (“Slight”) offered this summary of the suits and Musk’s defense:

*According to the plaintiffs, as Tesla’s controlling stockholder, Elon caused Tesla’s servile Board to approve the Acquisition of an insolvent SolarCity at a patently unfair price, following a highly flawed process, in order to bail out his (and other family members’) foundering investment in SolarCity. This, say the plaintiffs, was a clear breach of Elon’s fiduciary duty of loyalty. Given Elon’s status as a conflicted controlling stockholder, the plaintiffs maintain that the Court must review their claims under the **entire fairness standard**, which requires Elon to prove the Acquisition was the product of a fair process that yielded a fair price.*

*Elon counters that the plaintiffs failed to prove he was Tesla’s controlling stockholder, failed to prove the Tesla Board was conflicted, and failed to prove the Tesla stockholder vote approving the Acquisition was uninformed or coerced. Given these failures of proof, Elon maintains that he is entitled to deference under Delaware’s venerable **business judgment rule**. Should the Court disagree, Elon argues the trial evidence reveals the Acquisition was entirely fair, regardless of which party bore the burden of proof.*

Acquisition Background

Section 2

Entrepreneurial Histories

Tesla was founded in 2003. In the following year Musk became the largest investor by making a \$6.5 million investment. In August 2006 he penned a blog entitled, “The Secret Tesla Motors Master Plan (just between you and me).” In the blog he describes the purpose of Tesla is to speed the move from a “mine-and-burn hydrocarbon economy towards a solar electric economy.”

The blog was cited in the second sentence of the *Background of the Merger* in the proxy/prospectus as a reason for the Acquisition to occur. The proxy/prospectus also cites \$150 million of annual cost synergies and prospective consumer savings by manufacturing synergies and the like.

As for the economics of building cars, Tesla’s strategy focused on entering the high-end car market where consumers pay premium prices (the Roadster was launched in 2009) then introduce more affordable models to drive volumes higher and thereby gain economies of scale.

SolarCity, which was founded in 2006 by Musk’s cousins Peter and Lyndon Rive, sold and installed solar energy generation systems for retail, commercial and industrial customers. In 2012, the company went public at \$8 per share in an offering that raised \$106 million. Tesla went public in early 2010 via an IPO that raised \$260 million via shares sold for \$17 per share.

Prior to its acquisition by Tesla, there was a working relationship between the two companies. SolarCity offered free charging to Tesla Roadster owners at its charging stations, and SolarCity installed Tesla Powerwall home energy storage batteries.

Entrepreneurial Histories (cont.)

Musk served as non-executive chairman of SolarCity since July 2006, and at the time of the merger served as CEO and Chairman of Tesla. He owned ~22% of Tesla's common shares and ~22% of SolarCity's common shares. Tesla Director Anthony Gracias served on the SolarCity Board, too.

Excluding Musk, the SolarCity Board owned about 13% of SolarCity's shares of which ~8% was attributable to cousins Peter and Lyndon Rive. The Tesla Board owned less than 1% of Tesla's shares excluding Musk although three institutional shareholders collectively owned ~20% of the shares.

As shown on the next page, SolarCity could be described as a cash incinerator.

EBITDA and cash flow from operations had been deeply in the red since 2013. Capital expenditures exceeded \$1 billion annually since 2013, too. SolarCity may have been close to maxing out its borrowings with creditors and willingness of equity investors to participate in offerings. During 2015 and 2016 Space Exploration and Technologies Corporation ("SpaceX"), a privately held company in which Musk served as CEO and Chairman, purchased \$255 million of newly issued SolarCity bonds.

SolarCity's tightening liquidity position increased the urgency for the SolarCity Board to find a merger partner or raise more capital. In February 2016, Musk and Lyndon discussed the potential for TSLA to acquire SolarCity. Later in the spring when the two discussed a potential transaction, Lyndon told Musk that a bridge loan would have to be provided with an offer otherwise SolarCity would have to pursue an equity raise. Musk told Lyndon that Tesla would provide a bridge loan.

SolarCity Historical Financials

A cash incinerator

SolarCity Corporation (\$000)	LTM 2Q16	2015 FY	2014 FY	2013 FY	2012 FY	2011 FY	2Q16	1Q16
Cash	\$145,714	\$382,544	\$504,383	\$577,080	\$160,080	\$50,471	\$145,714	\$361,661
Current Assets	611,312	902,138	997,616	787,663	313,938	241,522	611,312	836,351
Net PP&E	6,082,914	4,922,440	2,898,710	1,704,928	1,002,756	550,030	6,082,914	5,578,840
Total Assets	8,224,080	7,287,118	4,551,219	2,809,534	1,342,300	813,173	8,224,080	7,959,205
Current Liabilities	\$1,100,947	\$1,193,362	\$566,513	\$338,206	\$213,978	\$246,886	\$1,100,947	\$1,211,346
Deferred Revenue Liability	1,092,069	870,066	483,922	273,062	4,965	5,491	1,092,069	1,013,617
Total Debt	3,346,195	2,855,923	1,516,609	665,614	289,456	98,117	3,346,195	3,252,549
Total Liabilities	6,352,705	5,552,555	3,208,847	1,960,410	1,049,079	602,467	6,352,705	6,237,133
Minority Interest	344,932	320,935	186,788	44,709	12,827	0	344,932	304,009
Common Equity	\$890,803	\$878,566	\$745,642	\$617,598	\$183,601	(\$37,662)	\$890,803	\$885,882
Non-Controlling Interest	635,640	535,062	409,942	186,817	96,793	122,646	635,640	532,181
Total Equity	1,526,443	1,413,628	1,155,584	804,415	280,394	84,984	1,526,443	1,418,063
Revenue	\$537,693	\$399,619	\$255,031	\$163,837	\$126,908	\$59,551	\$185,784	\$122,572
Recurring EBITDA	(608,636)	(506,904)	(248,328)	(109,371)	(72,721)	(52,012)	(95,523)	(194,795)
Recurring EBIT	(845,283)	(673,557)	(346,208)	(150,819)	(93,530)	(64,350)	(184,106)	(250,626)
Net Income	(999,514)	(768,822)	(375,230)	(151,758)	(113,726)	(73,714)	(250,257)	(283,105)
Reported Net Operating Income	(797,270)	(647,790)	(335,597)	(149,378)	(91,011)	(61,253)	(194,110)	(213,504)
Cash Flow from Operations	(\$866,979)	(\$789,884)	(\$217,849)	\$174,515	\$39,794	\$18,082	(\$195,896)	(\$193,115)
Cash Flow from Investing (CapEx)	(1,942,913)	(1,726,734)	(1,344,814)	(729,899)	(428,520)	(304,252)	(447,162)	(466,111)
Cash Flow from Financing	2,534,186	2,394,779	1,489,966	972,384	498,335	278,371	427,111	638,343
Common Shares Outstanding	100,267,138	97,863,602	96,521,000	91,009,000	74,913,000	10,465,000	100,267,138	98,296,422
Book Value per Share	\$8.88	\$8.98	\$7.73	\$6.79	\$2.45	(\$3.60)	\$8.88	\$9.01
Tangible BVPS	\$4.04	\$3.69	\$2.14	\$3.73	\$2.44	NA	\$4.04	\$3.84
Diluted EPS	(\$0.97)	(\$0.60)	(\$0.60)	(\$0.70)	(\$7.69)	\$0.76	(\$0.56)	(\$0.25)

Source: S&P Capital IQ Pro

Tesla Historical Financials

\$2.8B of cash raised during 1H16 via common and convert issues

TSLA Motors (\$000)	LTM 2Q16	2015 FY	2014 FY	2013 FY	2012 FY	2011 FY	2Q16	1Q16
Cash & Short Term Inv	\$3,246,301	\$1,196,908	\$1,905,713	\$845,889	\$201,890	\$280,327	\$3,246,301	\$1,441,789
Current Assets	5,203,705	2,782,006	3,180,073	1,265,939	524,768	372,838	5,203,705	3,239,543
Net PP&E	6,526,976	5,194,737	2,596,011	1,120,919	562,300	310,171	6,526,976	5,837,224
Total Assets	11,868,952	8,067,939	5,830,667	2,416,930	1,114,190	713,448	11,868,952	9,191,702
Current Liabilities	3,803,550	2,858,320	2,165,362	675,160	539,108	191,339	3,803,550	3,230,325
Total Debt	3,667,074	2,898,994	2,540,480	606,878	466,666	280,148	3,667,074	3,409,040
Total Liabilities	9,348,658	6,984,235	4,918,957	1,749,810	989,490	489,403	9,348,658	8,221,337
Minority Interest	0	0	0	0	0	0	0	0
Common Equity	2,520,294	1,083,704	911,710	667,120	124,700	224,045	2,520,294	970,365
Non-Controlling Interest	0	0	0	0	0	0	0	0
Total Equity	2,520,294	1,083,704	911,710	667,120	124,700	224,045	2,520,294	970,365
Total Revenue	4,568,234	4,046,025	3,198,356	2,013,496	413,256	204,242	1,270,017	1,147,048
EBITDA	(336,478)	(294,039)	45,242	44,800	(365,458)	(234,569)	(54,808)	(91,764)
EBIT	(930,259)	(716,629)	(186,689)	(61,283)	(394,283)	(251,488)	(238,040)	(248,224)
Net Income	(1,125,710)	(888,663)	(294,040)	(74,014)	(396,213)	(254,411)	(293,188)	(282,267)
Cash Flow from Operations	(332,458)	(524,499)	(57,337)	264,804	(263,815)	(128,034)	150,336	(249,605)
Cash Flow from Investing (CapEx)	(1,372,043)	(1,673,551)	(990,444)	(249,417)	(206,930)	(162,258)	(319,854)	(233,819)
Cash Flow from Financing	3,811,035	1,523,523	2,143,130	635,422	419,635	446,000	1,976,584	715,435
Common Shares Outstanding	740,075,000	657,125,000	628,440,000	615,454,950	571,071,370	522,651,525	740,075,000	669,290,000
Book Value per Share	\$3.41	\$1.65	\$1.45	\$1.08	\$0.22	\$0.43	\$1.45	\$0.00
Tangible BVPS	\$3.41	\$1.63	\$1.45	\$1.08	\$0.19	\$0.40	\$1.45	\$0.00
Diluted EPS	(\$1.69)	(\$1.39)	(\$0.47)	(\$0.12)	(\$0.74)	(\$0.51)	(\$0.42)	(\$0.43)

Source: S&P Capital IQ Pro

The Offer(s)

Section 3

The Initial Proposal

Tesla does not form a Special Committee

On February 27, 2016, Musk asked Tesla's CFO to prepare a financial analysis of a Tesla-SolarCity merger to present at a special board meeting on February 29. The Tesla Board then discussed the proposal but declined to pursue an acquisition due to production issues with the Model X that the board wanted resolved first; however, management was authorized to explore the matter further. A similar outcome occurred at the March board meeting.

On May 31, 2016, the Tesla Board directed management to evaluate an acquisition of SolarCity or other solar energy company (SolarCity was the undisputed market leader) given operational gains at Tesla. On June 20, the Tesla Board held a special meeting at which it determined that:

- The expertise of Musk and Gracias would be helpful to the board in the evaluation of a solar company acquisition;
- Musk and Gracias should recuse themselves from voting on an acquisition of SolarCity;
- The board should have the opportunity to discuss the matter without the presence of Musk and Gracias; and
- A majority of the disinterested stockholders of both Tesla and SolarCity must approve any transaction even though such approval is not required under Delaware law.

Gracias, like Musk, was a director of both Tesla (since May 2007) and SolarCity (from February 2012)

The Initial Proposal

SolarCity forms a Special Committee

On June 20, 2016, Tesla proposed that it acquire 100% of SolarCity's common shares via a stock swap in which SolarCity shareholders would receive 0.610 to 0.655 TSLA shares for each share they owned. Based upon the value of TSLA's shares as of June 17, the value of the proposed consideration was \$2.6 billion (\$26.50 per share) to \$2.8 billion (\$28.50 per share) and represented a 21% to 30% premium to Tesla's average price over the prior four weeks. The proposal was disclosed after the market close on June 21. Tesla's shares fell ~10% on June 22; SolarCity's shares rose ~3%.

On June 22, 2016, the SolarCity Board held a meeting that approved the creation of a Special Committee consisting of two independent and disinterested directors who were tasked to:

- Take action with respect to the Tesla proposal and any alternatives;
- Engage independent legal and financial advisors;
- Contact third parties regarding alternative transactions;
- Recommend to the board re the proposed transaction with Tesla or other proposals that might be received; and
- Evaluate, review and consider other potential strategic alternatives.

All values have been adjusted for Tesla's 5-for-1 stock dividend that was distributed in August 2020. The original offer was for 0.122 to 0.131 Tesla share for each SolarCity share, and the final agreed upon exchange ratio was 0.110 (or 0.550 as adjusted).

Negotiations

SolarCity's efforts for a fixed price, floating exchange ratio were rebuffed

Over the next several weeks, due diligence and reverse due diligence commenced including each party providing financial forecasts as drafts of a definitive agreement were circulated. Also, SolarCity held conversations with six strategic and six financial counterparties about an acquisition and discussed equity investments with three other entities. Ultimately, the one party that pursued an acquisition for several weeks elected to end its efforts for a variety of reasons. Also, one equity investment proposal implied less value than a combination with Tesla.

On July 9, 2016, SolarCity management advised the Special Committee that disclosure of the Tesla announcement had negatively impacted the company's financial position by delaying new financings and that the position prospectively would be affected by the soon to be released 2Q16 earnings which would include a lower growth guide and lower than expected cash.

The Special Committee's advisors subsequently requested that Tesla provide short-term financing, but the proposal was rejected by Tesla's advisors based upon prior discussions with Tesla's Board.

Among the negotiated deal points was how the exchange ratio would be structured. By mid-July, the Tesla Board rejected the Special Committee's proposal that the exchange ratio float based upon a fixed price per share for SolarCity.

Also, Tesla rebuffed efforts by the Special Committee to obtain the right to terminate if Tesla's share price fell below a certain level.

Acquisition Pricing

The 0.55 exchange ratio was 16% below the high end of the initial offer

On July 23, 2016, the SolarCity Special Committee directed its advisors to indicate to Tesla's advisors that it would be willing to recommend a transaction to the SolarCity board based upon an exchange ratio of 0.680 Tesla shares for each SolarCity share *and* the right to terminate if Tesla's shares dropped below \$35 per share during a calculation period prior to closing (Tesla's shares were trading around \$45 per share).

Tesla subsequently countered with an exchange ratio of 0.525, noting that the original June 20 proposal of 0.610 to 0.655 was made before due diligence had been conducted.

After rejecting a counteroffer of 0.6325, the Tesla Board proposed via its advisors, and the Special Committee accepted, a fixed exchange ratio of 0.550 with no collar if Tesla's shares fell below a predetermined band.

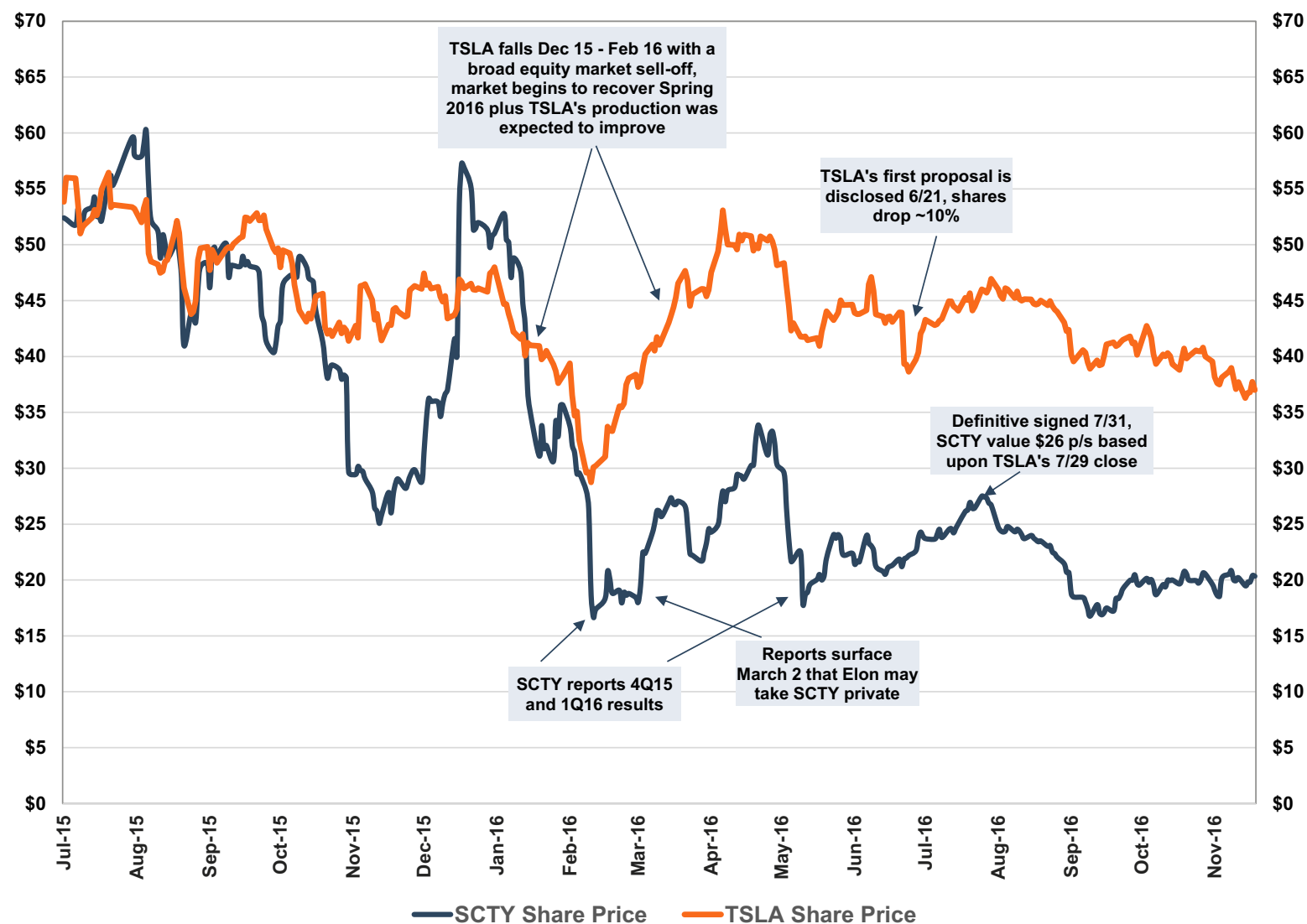
Interestingly, the proxy/prospectus does not indicate that Tesla's advisor Evercore or SolarCity's advisor Lazard considered a contribution analysis as part of their analyses to establish the exchange ratio (see page 19) relying instead on DCF and other valuation methods.

	8/1/16 Announce	11/21/16 Close
TSLA Share Price	\$46.00	\$36.90
<i>TSLA Pre-Stock Div'd</i>	<i>\$230.01</i>	<i>\$184.52</i>
Exchange Ratio	0.55	0.55
SCTY Price per Share	\$25.83	\$20.35
Common Shares	100,267	100,267
Equity Value	\$2,589,900	\$2,040,436
Debt (6/30 & 9/30)	3,346,195	3,536,191
Cash	(145,714)	(259,342)
Non-Controlling Interest	980,577	1,026,778
Enterprise Value	\$6,770,958	\$6,344,063
Ent Value / LTM Revenue	12.6x	10.2x
Ent Value / EBITDA	NA	NA
Price / EPS (17E)	NA	NA
Price / Book Value	291%	229%
Price / Tangible BV	639%	503%

The per share values for TSLA and the exchange ratio have been adjusted for TSLA's 5-for-1 stock dividend paid during August 2020.

Source: S&P Capital IQ Pro and the joint proxy/prospectus

TSLA & SCTY Share Price



Source: S&P Capital IQ Pro and Bloomberg

Contribution Analysis

	TSLA	SCTY	Combined	TSLA %	SCTY %
Common Shares (000)	752,180	100,267	<i>TSLA shares adj for the Aug 20 5:1 stock dividend</i>		
Exchange Ratio ^{1,2}		0.55	<i>0.11 exchange ratio pre stock dividend</i>		
Exchange Adjusted	752,180	55,243	807,423	93.2%	6.9%

Market Cap

	TSLA	SCTY	Combined	TSLA %	SCTY %
6/30/15	\$34,096,100	\$5,187,605	\$39,283,705	86.8%	13.2%
12/31/15	\$31,543,314	\$4,978,970	\$36,522,284	86.4%	13.6%
3/31/16	\$30,756,480	\$2,406,704	\$33,163,184	92.7%	7.3%
5/20/16	\$32,134,735	\$2,156,941	\$34,291,676	93.7%	6.3%
6/21/16	\$32,036,995	\$2,083,207	\$34,120,202	93.9%	6.1%
6/22/16	\$28,689,019	\$2,151,042	\$30,840,061	93.0%	7.0%
7/29/16	\$34,911,537	\$2,624,900	\$37,536,437	93.0%	7.0%

Last 12 Months @ 6/30/16

Revenues	\$4,568,234	\$537,693	\$5,105,927	89.5%	10.5%
EBITDA	(336,478)	(608,636)	(945,114)	35.6%	64.4%
EBIT	(930,259)	(845,283)	(1,775,542)	52.4%	47.6%
Net Income	(1,125,710)	(999,514)	(2,125,224)	53.0%	47.0%
Cash from Operations	(332,458)	(866,979)	(1,199,437)	27.7%	72.3%
Capital Expenditures	(1,315,204)	(1,976,605)	(3,291,809)	40.0%	60.0%

As of June 30, 2016

Cash	\$3,246,301	\$145,714	\$3,392,015	95.7%	4.3%
Net Fixed Assets	6,526,976	6,082,914	12,609,890	51.8%	48.2%
Debt	3,667,074	3,346,195	7,013,269	52.3%	47.7%
Net Debt	420,773	3,200,481	3,621,254	11.6%	88.4%
Common Equity	2,520,294	890,803	3,411,097	73.9%	26.1%
Tangible Common Equity	2,520,294	405,532	2,925,826	86.1%	13.9%

Source: S&P Capital IQ Pro

Closing Share Price

TSLA ³ SCTY

\$53.65	\$53.55
\$48.00	\$51.02
\$45.95	\$24.58
\$44.06	\$21.94
\$43.92	\$21.19
\$39.33	\$21.88
\$46.96	\$26.70

- 1) TSLA and SCTY disclosed after the market closed on June 21 that TSLA had proposed to acquire SCTY in an all-stock transaction via an exchange ratio of 0.610 to 0.655 that at the time valued SCTY at \$2.6B to \$2.8B. On Monday August 1, the companies announced the signing of the definitive agreement to merge (on 7/31) in which SCTY shareholders would receive 0.55 TSLA shares for each SCTY share.
- 2) After providing updated guidance re megawatts installed on 8/1, SCTY released 2Q16 data on 8/9. As a result, the most current financial data was as of 3/31 which entailed \$360M of cash vs \$146 million on June 30 – **so absent the initial offer on 6/21 and deal on 8/1, SCTY's shares could have dropped with the 8/9 release. SCTY's financing covenants included a minimum \$116M of monthly average cash.**

Delaware's Three Standards of Fairness Review

Section 4

Fairness

A board's fiduciary duty to shareholders is encapsulated by three mandates:

- Act in good faith;
- Duty of care (informed decision making); and
- Duty of loyalty (no self-dealing; conflicts disclosed).

There are three standards of review for Delaware corporations:

- Business judgment rule;
- Enhanced scrutiny; and
- Entire fairness.

Directors are generally shielded from courts second guessing their decisions by the **business judgment rule** provided there is no breach of duty to shareholders. The presumption is that non-conflicted directors made an informed decision in good faith. As a result, the burden of proof that a transaction is not fair and/or there was a breach of duty resides with the plaintiffs.

However, the burden of proof shifts to the directors if it is determined there was a breach of duty. If so, the decision will be judged based upon the **entire fairness standard**—i.e., fair price *and* fair dealing.

The intermediate **enhanced scrutiny** standard of review—which neither side argued in Tesla/SolarCity—covers possible conflicts of interest that may impact decision making. The standard is most often applied when a board moves to sell a company, cash out certain shareholders, or block a hostile takeover by adopting defensive measures.

Fairness

Fairness as an adjective means what is just, equitable, legitimate and consistent with rules and standards. As it relates to transactions, fairness is like valuation in that it is a range concept: transactions may not be fair, a close call, fair or very fair.

In order to avoid an actual or perceived breach of loyalty, boards are usually advised to form a special committee of disinterested and independent directors to negotiate a transaction. In this context disinterested means no interest in the transaction, or the same as other shareholders. Independent references no relationship with an interested party to the transaction that could impact the director's decision making (e.g., familial relationships, past business ties, etc.).

The committee should be free of influence from conflicted board members and/or management and have free reign to hire independent counsel and financial advisors.

Generally, the business judgment rule should be the standard for mergers involving a controlling shareholder where a special committee runs the process and an informed, uncoerced majority of the minority vote to approve a merger.

Fairness is subjective, but a good defense is a transaction in which consideration to be paid is demonstrably fair.

Fairness

Fair price, whether viewed from the perspective of the business judgment rule or entire fairness Standard, addresses the economics of a transaction. Fair dealing examines the process:

- Who initiated the transaction?
- Who negotiated the transaction?
- What alternatives did the board consider?
- If shopped, who did the shopping?
- Did the board or special committee hire counsel and a financial advisor?
- Did the control shareholder withhold information from directors?
- What efforts have been obtained to improve any offer(s)?
- Did the board/committee have sufficient time to review the information?
- Are there agreements that might be seen as shifting value from shareholders to management and directors (e.g., new/richer employment agreements)?

The Court Weighs the Issues

Section 5

The Plaintiffs' Issues

Musk's disloyal conduct as a controlling shareholder and director caused Tesla to pay excessive shares for an insolvent company

There were four counts to be adjudicated.

Counts I and II assert derivate breach of the duty of loyalty against Musk in his capacities as controlling shareholder and a director by causing the company to acquire an insolvent SolarCity.

Count III asserts a claim of unjust enrichment against Musk in connection with the Tesla stock he received.

Count IV asserts that the Acquisition constituted waste.

There was no complaint against Musk as CEO of Tesla for a duty of care breach, which Slight's viewed as significant. Tesla's certificate of incorporation includes an exculpatory provision as permitted under the Delaware General Corporation Law that exculpates breaches of duty of care as a director but not as an officer (i.e., Musk as CEO vs Musk as director).

Slight's addresses the "gating question" of whether the standard of review should be the deferential business judgment rule or entire fairness standard without pondering the issues too much (Musk is/is not a controlling shareholder, absence of a special committee, whether the proxy/prospectus had adequate disclosures, etc.). ***Slight's assumes the "Plaintiffs' best case on standard of review—that entire fairness applies."***

Boards of Directors and +5% Shareholders

Disinterested director(s) and special committee members

TSLA Directors & 5% Holders				Shares (M)	Disinterested
Elon Musk	168.7	22.4%	No - SCTY Chairman and largest investor		
Antonio Gracias	2.2	0.3%	No - SCTY Director		
Kimball Musk	1.0	0.1%	No - Familial as Elon's brother		
Brad Buss	0.6	0.1%	No - Past SCTY CFO and consultant		
Robyn Denholm	0.4	0.0%	Yes - Led board review and directed Evercore & Wachtell		
Ira Ehrenpreis	0.3	0.0%	No - SCTY financial ties, fund partner Pfund was a SCTY director		
Stephen Jurvetson	0.4	0.1%	No - SCTY financial ties and SpaceX investor		
Total	173.5	23.1%			
FMR (Fidelity)	66.7	8.9%			
Baillie Gifford	53.6	7.1%			
T. Rowe Price	39.4	5.2%			
Other 5% Holders	159.6	21.2%			

Advisors: Evercore and Wachtell, Lipton, Rosen & Katz

SCTY Directors & 5% Holders				Shares (M)	Special Committee
Elon Musk	22.2	22.1%	No - TSLA CEO and largest investor		
Lyndon Rive	4.0	4.0%	No - Elon & Kimball's cousin		
Peter Rive	3.9	3.9%	No - Elon & Kimball's cousin		
Nancy Pfund	1.6	1.5%	Special Committee (though partner in DBL fund with Ehrenpreis)		
Don Kendall	0.1	0.1%	Special Committee		
Antoni Gracias	0.2	0.2%	No - TSLA director		
Jeffrey Straubel	0.8	0.8%	No - Previously the Chief Technology Officer of TSLA		
Total	32.8	32.7%			
FMR (Fidelity)	12.0	12.0%			
Other 5% Holders	12.0	12.0%			

Advisors: Lazard Freres and Skadden, Arps, Meagher & Flom

Fair Process

Problems with the process

Entire Fairness is a composite of fair dealing and fair price according to Slight's though he likens the path to the idiom that all roads lead to Rome (fair price) though a fair price "does not ameliorate a process that was beyond unfair."

Although Slight's ruled in favor of Musk, he took the defendants to task for the process followed.

There was a right way to structure the deal process within Tesla that likely would have obviated the need for litigation and judicial second guessing of fiduciary conduct. First and foremost, Elon should have stepped away from the Tesla Board's consideration of the Acquisition entirely, providing targeted input only when asked to do so under clearly recorded protocols.

The Tesla Board should have formed a special committee comprised of indisputably independent directors, even if that meant it was a committee of one. The decision to submit the Acquisition for approval by a majority of the minority of Tesla's stockholders was laudable and had the deal process otherwise been more compliant with the guidance provided by this court and our Supreme Court over many decades, it is likely there would be no basis to challenge the stockholder vote as uninformed. Of course, none of that happened.

Musk's presence was "problematic," and his recusals were "fluid" though Slight's determines that his advocacy efforts were overcome by (undisputed) independent director Denholm leading the process and a board that sought to evaluate the Acquisition on its merits.

Fair Process

Positive factors in the process

Slights found the following attributes to be positive about the process:

- **Timing** – Plaintiffs asserted that the timing was geared to rescue SolarCity, though Slights found there was no “bailout” and the timing worked for Tesla after the production issues were resolved.
- **Structure** – The Tesla Board required a majority of disinterested stockholders to approve the Acquisition, which under Delaware case law is indicative of fairness because the controlling shareholder is disabled provided the shareholders are fully informed and not coerced. (Slights did not rule on the “interesting argument” that institutional shareholders who owned shares in both companies should not be counted as disinterested.)
- **Share Reduction** – The board reduced the exchange ratio after due diligence results were known.
- **Board was not “Dominated” by Musk** – Slights notes board pushback of Musk’s efforts to initiate a transaction in early 2016, board support for a lower exchange ratio than Musk initially suggested, etc. as evidence Musk’s “managerial supremacy” did not translate into board dominance.
- **Market and Tesla Board Knowledge** – That SolarCity had liquidity issues was known because some SolarCity analysts described the Acquisition as a “bailout,” Evercore conducted extensive diligence on liquidity, and the request for a bridge loan confirmed a tight liquidity position.
- **Denholm** – Denholm functionally was a single member special committee whose “credible and unequivocal endorsement of the Acquisition is highly persuasive of its fairness.”

The Plaintiffs' Issues

Plaintiffs were “all in” that SolarCity was insolvent and worthless

The Plaintiffs were described as “all in” that SolarCity was insolvent and that any price was too high because the equity was worthless. In their view, SolarCity’s stock price did not reflect non-public information about its liquidity situation that emerged in 2015 and intensified in 2016 such that SolarCity did not have a viable plan to address it (bankers had advised against a traditional equity raise).

Plaintiffs also alleged that the \$150 million of synergies were not recognized and Evercore’s fairness opinion was unreliable because Evercore allegedly lowered its professional standards to achieve Musk’s objectives.

Slight’s attributed SolarCity’s cash challenges to rapid growth, not market disinterest in its products or poor business execution. That may be true, but SolarCity’s liquidity position was tenuous. Musk agreed in a July 24 board meeting that SolarCity’s liquidity issues should lower the deal value but reiterated his belief that the “strategic rationale was still intact” for the Acquisition.

Timing of the Acquisition announcement on August 1 is interesting because it occurred a little over a week before 2Q16 results were released on August 9 when SolarCity reported \$146 million of cash compared to \$362 million as of March 31 and only \$30 million over its cash liquidity covenant with Bank of America and other lenders.

Also, the proxy prospectus did not disclose that Musk and other insiders purchased \$100 million of one-year, 6.5% bonds on August 23 to address SolarCity’s tight liquidity and presumably ensure there would be no breach of its liquidity covenant with lenders and reps made in the definitive agreement.

The Court Weighs the Issues

Musk convinced the Court that SolarCity was valuable, the price fair and there was no unjust enrichment or corporate waste

Slights offered the following points in his review of the Plaintiffs' charges:

- ***SolarCity was not Insolvent*** – Credible evidence was presented that while SolarCity was “cash-strapped to a dangerous degree,” the company was solvent, valuable and not in danger of bankruptcy.
- ***DCF Analyses were Unhelpful*** – Slights was not convinced by either expert that a DCF analysis was the correct method to assess value and fairness given the facts and circumstances.
- ***Market Evidence of Fair Price*** – Market evidence is a “reliable indicator” of fair price and Delaware courts usually view favorably market-based indications of value over other methods because robust markets reflect the collective judgements of many investors rather than a few creating a model.
- ***Market for SolarCity was Efficient*** – Slights disagreed with the Plaintiffs' position that SolarCity's share price was unreliable because the market lacked information regarding the degree to which SolarCity was struggling with liquidity.
- ***Market's Pre-Acquisition View of SolarCity*** -- SolarCity traded around \$21 per share and had a market cap of \$2.1 billion immediately before the initial offer was disclosed on June 21. When the deal closed in November, SolarCity was effectively acquired for no premium given a deal value of \$20.35 per share.

The Court Weighs the Issues

Musk convinced the Court that SolarCity was valuable, the price fair and there was no unjust enrichment or corporate waste

- **Shareholder Approval** – 85% of the disinterested shareholders voted to approve the Acquisition. As noted previously, Slight's never ruled whether institutional shareholders such as Fidelity that owned shares in both companies should be classified as interested rather than disinterested.
- **SolarCity's Cash Flows Support a Fair Price** – Slight's accepted projections that SolarCity would produce \$3 billion of cash flow of which ~\$1 billion had been recognized when the opinion was drafted.
- **Evercore's FO Supports a Fair Price** – Slight's notes courts are sometimes skeptical of fairness opinions; however, he was not skeptical of Evercore's opinion, noting extensive diligence, the immediate alerting of the Tesla Board about SolarCity's liquidity situation and the absence of prior work by Evercore for Tesla.
- **Potential Synergies** – Although Plaintiffs asserted that the Court should not consider synergies because they are speculative, and Musk presented no evidence that Tesla has realized any, Delaware law allows for elements of future value. Slight's goes on to note synergies (cost saves, cross sales, and repositioning Tesla as an integrated alternative energy company from an electric car manufacturer) are still unfolding, and the astronomic rise in Tesla's stock price is noteworthy.
- **Unjust Enrichment and Corporate Waste** – Because Slight's ruled the Acquisition to be entirely fair, there was no unjust enrichment or corporate waste.

The Ruling

Tesla walked the entirely fair line even though the process was less than ideal as the key point for the Court was a deal that was demonstrably fair

Vice Chancellor Slights summed up his ruling as follows:

Even assuming (without deciding) that Elon was Tesla's controlling stockholder, the Tesla Board was conflicted, and the vote of the majority Tesla's minority stockholders approving the Acquisition did not trigger business judgment review, such that entire fairness is the standard of review, the persuasive evidence reveals that the Acquisition was entirely fair.

The process employed by the Tesla Board to negotiate and ultimately recommend the Acquisition was far from perfect. Elon was more involved in the process than a conflicted fiduciary should be. And conflicts among other Tesla Board members were not completely neutralized. With that said, the Tesla Board meaningfully vetted the Acquisition, and Elon did not stand in its way.

Equally if not more important, the preponderance of the evidence reveals that Tesla paid a fair price—SolarCity was, at a minimum, worth what Tesla paid for it, and the Acquisition otherwise was highly beneficial to Tesla. Indeed, the Acquisition marked a vital step forward for a company that had for years made clear to the market and its stockholders that it intended to expand from an electric car manufacturer to an alternative energy company.

The Court's verdict, therefore, is for the defense.

Additional Thoughts

Section 6

It Worked Out

Tesla's shares rose a “ton”

[In an opinion piece](#) date April 28, 2022, *Bloomberg's* Matt Levine opines that Slight's “heart isn't in it” in terms of criticizing Musk and the Tesla Board for the process that was followed. He summarizes Slight's rationale for finding the Acquisition to be entirely fair as “the stock has gone up a ton” since the deal closed though Slight's acknowledges how much is attributable to the Acquisition is unknown.

Tesla's shares rose from ~\$37 per share when the Acquisition closed in November 2016 to ~\$1,000 per share when the Opinion was published on April 27, 2022. Other factors drove the share price, too: improving car deliveries; the opening of monetary and fiscal spigots in March 2020 in response to COVID; consistent and rising operating profitability since 3Q19; and the inclusion of Tesla in the S&P 500 in December 2020.

Markets anticipate and weigh probabilities; investors do not wait for press releases. Stock prices reflect a probability distribution of outcomes. It is probable that SolarCity's share price in 2016 reflected some investor weighting of an acquisition by Tesla before the initial offer was disclosed on June 21 and even before Musk made comments about taking the company private in early March.

The reason is because SolarCity was a cash incinerator, requiring significant external funding to cover operating losses and capital expenditures. How much weighting and at what price is unknowable. But investors apparently had significant concerns because SolarCity's share price fell by ~37% over two days following the release of 4Q15 results on February 9 and tumbled 67% from year-end. Something would have to happen because the cash burn rate was not sustainable.

It Worked Out

Did the Plaintiffs fumble the ball?

The Plaintiffs' argument with the Court might have been stronger had they argued the Acquisition did not make sense in the context of Tesla assuming over \$3 billion of net debt and the funding requirements to cover operating losses and capital expenditures. Maybe that would not have mattered because the Plaintiffs' expert who testified about solvency did not convince Slights at all.

If SolarCity had been required to obtain a solvency opinion with a pre-deal debt financing, it might have been hard to obtain given four questions that have to be affirmatively addressed:

- Does the fair value of the assets exceed the fair value of the liabilities?
- Does the fair value of the assets exceed the fair value of the liabilities and surplus?
- Can the company pay (or refinance) its obligations as they become due?
- Does the company operate with adequate capital?

Slights considered it significant that SolarCity's unaffected public market share price (i.e., prior to the June 21 initial offer disclosure) did not indicate imminent solvency issues. There is no mention of trading activity in SolarCity's bonds or bank loans that could confirm or refute Slights take on the unaffected share price though SolarCity's lead lender, Bank of America, reportedly sought more business even after the OCC downgraded the credit in the annual SNC exam.

It Worked Out

Did the Plaintiffs fumble the ball?

Also, it is surprising that neither Evercore or Lazard specifically considered a contribution analysis as part of each firm's fairness analysis. A contribution analysis may be simplistic, but it is insightful about what each party contributes to the pro forma company.

As shown on page 19, SolarCity's 6.9% ownership in Tesla after the Acquisition closed represented a 13% premium to SolarCity's 6.1% pro-rata of the combined market caps on June 21. Interestingly, as of June 30, 2015, and year-end 2015, SolarCity's market cap was roughly double the announced Acquisition value at ~\$5 billion and would imply SolarCity should own ~14% of the pro forma company absent any premium. In effect, the equity market and both boards recognized significant deterioration in SolarCity's financial position from 2015.

The Court found the price to be "entirely fair" yet the mosaic inclusive of the balance sheet is notable. Page 19 illustrates the amount of leverage SolarCity had incurred with \$3.2 billion of net debt as of June 30, 2016, compared to only \$421 million for Tesla. Even if SolarCity's equity could be acquired for a nominal value of say \$1.0 million, is it fair to Tesla shareholders to assume SolarCity's debt given deficit cash from operations and sizable capital expenditure requirements?

A final point to contemplate in terms of fairness is the Acquisition consideration: 55.2 million Tesla common shares adjusted for the August 2020 5-for-1 stock dividend. Much of the commentary about the Acquisition, including at times by the Court, speaks to "price" but what was negotiated was the exchange ratio. Boards contemplating a merger when the predominant consideration is the buyer's shares should focus on this first and what all that entails rather than a myopic focus on "price."

Appendix

Section 7

Representative Transactions

National Retail Insurance Brokerage

Dividend & Recapitalization Transaction of \$50 million

Mercer Capital rendered a solvency opinion on behalf of the board of directors of the Company

— April 2022 —



Has entered into a definitive agreement to acquire



Forsyth, Georgia

Mercer Capital served as exclusive financial advisor to Robins Financial Credit Union

— March 2022 —



has agreed to acquire the majority of the assets and liabilities of



Smyrna, Georgia

Mercer Capital served as exclusive financial advisor to Georgia's Own Credit Union

— February 2022 —



has acquired



Vining-Sparks IBG, L.P.
Memphis, Tennessee

Mercer Capital provided financial advisory services and rendered a fairness opinion on behalf of Vining-Sparks

— October 2021 —



KYZEN Corporation
Nashville, TN

Cash-Out Merger

Mercer Capital served as financial advisor to the board of directors to establish a range of value at which certain shareholders would receive cash and rendered a fairness opinion in a go-private transaction

— August 2021 —



has acquired



LTC Solutions
Cape Coral, Florida

Mercer Capital served as exclusive financial advisor to Krause Brokerage Services

— July 2021 —



has entered into an agreement to acquire



Landmark Community Bank
Collierville, Tennessee

Mercer Capital rendered a fairness opinion on behalf of Simmons First National Corporation

— June 2021 —



National Cellular Retailer

\$75 million dividend recapitalization transaction
Mercer Capital rendered a solvency opinion on behalf of the board of directors of the company

— May 2021 —

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