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Delaware Chancery Rules Tesla's $2.6 Billion Acquisition of SolarCity "Entirely Fair"

Court Rules for Defense Despite Plaintiff-Friendly Entire-Fairness Standard, Finding That the Price Paid Was Fair Notwithstanding "Far From Perfect" Process.

On April 27, 2022, Vice Chancellor Slights of the Delaware Court of Chancery issued a lengthy decision handing a rare post-trial win to a controlling stockholder defendant in a litigation governed by Delaware's stringent "entire fairness" test. In *In re Tesla Motors, Inc. Stockholder Litigation*, the Court of Chancery held that, notwithstanding a variety of imperfections in the process leading up to the deal, defendant Elon Musk had proven that Tesla Motors, Inc. paid a fair price in its $2.6 billion stock-for-stock acquisition of SolarCity Corporation.

Plaintiffs alleged that Musk, who owned approximately 22% of both Tesla and SolarCity when the acquisition was negotiated, was a conflicted controlling stockholder standing on both sides of the deal. Plaintiffs also alleged that Musk orchestrated the acquisition to bail out SolarCity, which Plaintiffs claimed was insolvent and therefore worthless. Plaintiffs sued Musk and the other members of the Tesla board. The defendants besides Musk settled well before trial for $60 million funded by insurance, while Musk continued litigating.

Although the parties debated extensively whether Musk controlled Tesla, the Vice Chancellor determined that "there is no point to be served by pondering" the applicable standard of review because Musk prevailed even under entire fairness, "the highest degree of scrutiny recognized in [Delaware] law." The Court thus focused on the two components of entire fairness: Fair process and fair price. "'[P]erfection is not possible, or expected,'" but a fair process "'has significant probative value'" regarding the fairness of the price, and fair price is the "'paramount consideration'" under entire fairness.

The Vice Chancellor found that Musk's participation in the transaction process on both sides "at times, was problematic," and hindered the reliability of the deal price as evidence of fair value. But any control Musk attempted to wield over the acquisition "was effectively neutralized by a [Tesla] board focused on the bona fides of the acquisition," and which retained control of negotiations and acted independently.

In the end, the Court found the price fair. Importantly, because both sides agreed that SolarCity's stock traded in an efficient public market and SolarCity's liquidity problems were disclosed, the Court relied heavily on market indicia of value, including that the deal price was *lower* than SolarCity's unaffected stock price. The Court also found "compelling" the fact that the deal was approved by 85% of the shares voted by disinterested stockholders, representing "largely extremely sophisticated institutional investors." The Court also believed the price fairness was supported by, among other things, deal synergies, long-term value to Tesla from SolarCity's cash flows, and the valuation work performed by Tesla's financial advisor.

The Court remarked that Defendants "likely could have avoided this expensive and time-consuming litigation had they just adopted" certain process protections developed by Delaware courts to avoid entire fairness review in controlled company transactions, including conditioning the acquisition from the outset on approval of both a majority of Tesla's disinterested stockholders (a deal feature the Tesla board did adopt here) and a special committee of independent directors (which Tesla did <u>not</u> adopt). The Court described its opinion as "a parable of unnecessary peril" for Musk, "despite the outcome."

The *Tesla* post-trial opinion represents both a rare example of a post-trial entire fairness ruling, and also one of only a handful of entire fairness cases where the defense prevailed by proving fair price at trial despite perceived flaws in the deal process. The opinion reinforces the litigation risks incident to controlling stockholder transactions and the importance of procedural and substantive process protections in defending against subsequent litigations, even if not robust enough to restore business judgment review.

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