

Tesla: A Lesson In Failure Of Board Oversight Of Senior Management

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Tesla...a name that is magical to many both because of the foreign-born scientist after whom the company is named and because of the wunderkind, Elon Musk, who founded the company. Musk has been a successful marketer of future visions. Investors have long been willing to commit their dollars to Tesla equity and debt notwithstanding its continuing need to issue additional equity and debt to survive until cash flow may [or may not] turn positive.

But, Tesla presents us another picture, too—that of a visionary entrepreneur, who does not understand the demands placed upon publicly owned companies. The most recent illustration of this is Musk's tweet claiming that he had financial commitments to take the company private. Musk made these claims after criticizing investors, who were aggressively selling Tesla shares short. Pending litigation might yet establish that Musk's tweet was intended to defraud those short sellers.

During the last week of September, Tesla shares sold off sharply [by 14%] upon the announcement by the U. S. Securities & Exchange Commission that it was seeking to remove Musk as CEO and Board Chairman of Tesla. Musk's response was to threaten to litigate. His board of directors unanimously and immediately supported his position. Investors feared a severe decline in the stock's value without Musk's continuing involvement in the management of the company.

Musk's recent erratic, emotional behavior illustrates the difficulty of the visionary entrepreneur successfully overseeing the realization of his vision especially when that entrepreneur is pursuing several elusive visions at the same time: privatization of space travel and massive, technological disruption of both the auto and truck transportation and energy industries.

When Tesla became a public company, its board of directors assumed the weighty responsibility to oversee, question sharply, direct, and guide Musk and Tesla's senior managers. Before going public, Musk had hand-picked the board members. Not surprisingly the directors did not ask the hard questions and provide Musk and his managers the careful, continuing guidance required to make the long, difficult journey from technological vision to becoming a major competitor in the transportation industry. An earlier instance of this failure of the board members occurred when SolarCity, another visionary company founded by Musk, was suffering a decline in business and liquidity challenge. Ultimately, the board acquiesced in Musk's desire to merge the failing SolarCity into Tesla, which at that time still had sufficient support of investors to continue to avoid illiquidity by issuing additional equity and debt.

Most recently, the board members appear not to have recognized the increasingly erratic behavior of Musk and insisted that he find senior managers to whom he could delegate substantial responsibility for all the myriad tasks required for Tesla to achieve the highly ambitious production and marketing goals that Musk kept promising investors.

The board, also, failed to rein in Musk taking to tweets and other social media to challenge the premises of the Tesla short sellers. The board instead acquiesced in Musk performing the daily tasks of chief information officer and investor relations department as

well as CEO. With the board failing to act as the corporate regulator that is its function, the Securities & Exchange Commission stepped in and threatened to remove Musk as Tesla's board chairman and CEO. Musk and his board initially threatened war with the SEC. Fortunately, cooler heads prevailed. The SEC's settlement agreement with Tesla and Musk contemplates the removal of Musk as board chairman for three years, board acceptance of responsibility for control over corporate communications, SEC approval of all corporate communications by Tesla and Musk, two \$20 million fines, one paid by Tesla and one by Musk, the appointment of two additional independent members to Tesla's board, and the establishment of a committee of independent board members to oversee Tesla's corporate communications.

Experts in corporate governance have followed these developments closely and expressed varying views as to the merits of the SEC's settlement agreement. All agree, however, that Tesla illustrates a clear failure of board oversight of Musk and senior management and given Musk's personality and behavior there remains great uncertainty whether Tesla under Musk will succeed in the implementation of the vision that Musk so artfully and dramatically has articulated.