

# CtW Investment Group

Antonio J. Gracias  
Lead Independent Director  
Tesla Motors, Inc.  
3500 Deer Creek Road  
Palo Alto, California 94304  
Attention: General Counsel/Legal

August 1, 2014

Dear Mr. Gracias:

No doubt investors are more than pleased with Tesla's phenomenal stock performance over the last several years. However, the soaring stock price should not be a distraction from the directors' critical task of ensuring the company maintains a robust governance structure that is appropriate for its current stage of development. It is widely accepted among long-term investors that fostering effective corporate governance is essential for sustainable value creation.

Four years out from its IPO, Tesla's board should consider transitioning from a governance model that is reminiscent of the firm's venture-backed roots to one that reflects Tesla's more dispersed institutional investor base. As far as we can tell, the board has not disclosed many details about board succession planning in its recent proxy statement or at the annual meeting of shareholders. For these reasons, we urge the board to restructure Tesla's governance to become more consistent with that of other publicly traded mature companies.

Some initial reforms having the most immediate impact for shareholders that the board should consider include:

- Commit to bringing on new independent directors that are free from any association with Tesla's CEO & Chair, Elon Musk, or his affiliated companies and strive to make the board's makeup more diverse;
- Place board leadership in the hands of a truly independent director by separating the roles of Chairman and CEO;
- Declassify the board so that shareholders may have an annual say on the election of all directors; and
- Make the election process meaningful by adopting a majority voting standard.

The CtW Investment Group works with union sponsored pension funds to enhance long-term shareholder value through active ownership. These funds have \$250 billion in assets under management and are substantial Tesla shareholders.

***Tesla's board needs to be more representative of its broader shareholder base and improve independence.***

While the recent departure from the board of the Daimler representative served to boost the board's overall independence level to a nominal supermajority, the multiple ties between the independent directors and Elon Musk or his related companies, puts these directors' ability to exercise independent judgment at risk. We are concerned that all but one of the directors classified as independent by the board maintain outside affiliations with Mr. Musk. You and Mr. Jurvetson serve on the board of SpaceX, and your companies, as well as a third director, Mr. Ehrenpreis, are investors in SpaceX, a company founded Mr. Musk and where he serves as the

CEO and Chair. Additionally, you are also an investor and a director of SolarCity where Mr. Musk is Chairman of the board.

Moreover, the directors were appointed to the board by virtue of their companies' investments in Tesla. While this arrangement was appropriate when Tesla was a tightly-held private company, we note that each of those firms have subsequently diminished their stakes to well below 1% since the IPO. If ownership served as the basis for determining the board's composition, part of the impetus for these directors remaining on the board is no longer relevant. As Tesla matures, it will require directors with a different set of competencies aligned with the company's needs in each particular stage in its development. It is incumbent on the board to address these changing requirements proactively. In light of this, we believe these directors should be gradually rotated off the board to make room for new independent directors that can guide Tesla through its new stage of development.

***Greater board diversity is likely to benefit Tesla's performance.***

We believe Tesla's board would benefit by increasing the diversity of its board of directors, including race, gender, culture, and geography. For instance, Tesla's top management and board of directors are void of any women while many of Tesla's competitors have some female representation within these ranks. In addition, the current directors do not only appear to have professional or personal ties to our current CEO but their primary places of business are located in Silicon Valley, making them part of an industry culture known for its homogeneity. Greater diversity often brings varied perspectives and non-traditional approaches to problems which can lead to better decision making and enhance board effectiveness. Tesla's ongoing expansion in China would, for instance, benefit from having directors from this region that could oversee the expansion.

In recent years, a range of studies have found a positive link between company performance and greater board diversity. For example, research conducted by the Credit Suisse Research Institute, which examined the performance of 2,360 companies globally over a six year period, found that the share price performance at companies with some female participation on their boards outperformed companies that lacked any female representation.<sup>1</sup>

***Board leadership should be entrusted to an independent director.***

We, like many investors, are generally in favor of separating the roles of chairman and CEO because we believe tasking the CEO with monitoring his own performance is a fundamentally flawed and ineffective approach to management oversight. Tesla relies on the lead independent director model, which we regard as a weaker alternative because of our aforementioned concerns with the board's overall independence.

Further, there is a strong case for segregating the duties at Tesla beyond the usual conflicts related to inhabiting both roles. Overseeing the complexity of Tesla's day-to-day operations is certainly a demanding job. Because Mr. Musk is also the Chairman and CEO of SpaceX, as well as Chairman of the board of Solar City, another publicly traded company, he may run the risk of being spread too thinly to perform effectively in all of these roles. Therefore, it becomes critical Tesla's board entrust the role of Chairman to an independent director so that Mr. Musk may focus his full attention on his role as CEO of Tesla and to provide a better balance of power between the CEO and the board.

***Make director elections count.***

Director elections should be more than just a symbolic exercise. Tesla's board ought to create a director election framework that ensures shareholders' votes count. This would include giving shareholders an annual vote on director elections and providing for a majority vote standard. Recognizing the value this

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<sup>1</sup> "Gender Diversity and Corporate Performance," Credit Suisse Research Institute, August 2012.

brings, more companies have embraced these two norms. In fact, 90% of companies in the S&P 500 have annually elected boards (60% of Russell 3000) and 90% of S&P 500 companies have a majority vote standard (46% of Russell 3000).<sup>2</sup> These are fundamental governance improvements the board should adopt immediately.

**Conclusion**

While Tesla's growth has been impressive thus far and should be celebrated, significant challenges to its continued success abound. Its planned expansion within China, for instance, is a critical driver of future growth but is not without considerable hurdles. It is therefore imperative that the board and the company's overall governance framework should evolve in order to effectively meet these emerging challenges. We hope you will consider the proposed changes and are looking forward to your response.

Sincerely,



Dieter Waizenegger  
Executive Director

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<sup>2</sup> "US Corporate Governance: Boards of Directors Face Increased Scrutiny", Skadden, Arps, Slate, Meagher, & Flom, Jan. 16, 2014: