June 28, 2016

Antonio J. Gracias
Lead Independent Director
Tesla Motors, Inc.
3500 Deer Creek Road
Palo Alto, CA 94304
Attention: Corporate Secretary

Dear Mr. Gracias:

In the wake of the proposed acquisition of SolarCity, we are compelled to reiterate our long-standing concern about corporate governance at Tesla. The market's hostile reaction to the deal demonstrates Tesla's failure to establish a corporate governance structure that inspires confidence that the terms are being negotiated in the best interest of Tesla investors. This is particularly questionable when six out of our seven board members have ties to SolarCity. It is therefore critical that the Tesla board, before finalizing the deal, move immediately to remedy its underlying governance deficiencies by implementing the following proposals:

- Immediately recruit two genuinely independent directors to the board to form a "Special Transactions Committee" empowered to fully review the proposed SolarCity acquisition and recommend whether it should proceed as planned or if changes are necessary, up to and including terminating the offer;
- Permanently expand the size of the board to include two new independent directors on a permanent basis;
- Separate the roles of board Chairman and Chief Executive Officer;
- Declassify the board so that stockholders may have an annual say on the election of all directors; and
- Amend the corporate governance guidelines of Tesla to state that immediate family members of any current board member or member of the senior executive team should not concurrently serve on the board of directors.[1]

The CtW Investment Group works with union-sponsored pension funds to enhance long-term stockholder value through active ownership. These funds have $250 billion in assets under management and are substantial Tesla stockholders. This letter explains the basis for our concerns about governance at Tesla and proposes steps the company should take to remedy the problem.

As you know, we have expressed our concern in the past to Tesla about its governance structure and practices.[2] We noted in our letter to you in 2014 that governance practices at the company needed to evolve beyond what was appropriate during the days when Tesla was a private,

[1] To be clear, this step would require the resignation from the board of Kimbal Musk.
[2] See Letter, Dieter Waizenegger to Antonio J. Gracias, August 1, 2014.

venture capital-backed firm if it was to be successful as a large public corporation.[3] It is widely accepted by long-term investors that insuring effective corporate governance is critical to sustaining the process of value creation at public companies like Tesla. The board of directors of Tesla must maintain a robust governance structure appropriate to the current stage of development of the company.

A key reason for a company like Tesla to become publicly traded is to be able to use its stock as currency to acquire important assets, including other companies. Strategic acquisitions by public companies are vital to maintaining competitive success and growing the value of the business. Conversely, an unwise acquisition not only reduces shareholder value, it may distract key executives from other initiatives critical to long-term strategy. A public company that cannot manage that acquisition process smoothly and effectively cannot be a successful company in the long run. Effective corporate governance mechanisms are vital to this process.

The recent announcement of the proposed acquisition of SolarCity by Tesla demonstrates clearly that Tesla has not adequately addressed this issue. We believe that the process the board is following in the SolarCity acquisition is flawed and that this transaction is at serious risk because of the current corporate governance structure at Tesla. The fiercely negative reaction to the proposed transaction only highlights the flawed process and underscores our continuing concern about governance at the company. Therefore, we believe the board of directors at Tesla must be restructured in order to insure that stockholder interests are protected during this proposed acquisition and going forward.

Hostile reaction to the SolarCity acquisition highlights Tesla's governance problems

Tesla announced its offer to acquire SolarCity on June 21, 2016. Market reaction to the announcement was negative and fierce. One headline referred to "carnage" in the wake of the announcement.[4] While it is not unusual for the stock of a large publicly traded company to decline slightly when the company announces a major acquisition, within days Tesla had lost $3.4 billion, more than 10% of its market capitalization.[5] That is an exceptionally large loss. One newspaper analysis said the deal had "major flaws."[6] Another assessment expressed disbelief in Mr. Musk's claim that the deal would help Tesla become a "trillion dollar" company.[7]

In other words, whether or not the transaction makes ultimate sense for Tesla – and we are not confident that that is the case, absent independent and unbiased analysis – it is clear that the transaction planning was poorly managed, at the very least. In our view, that is a clear sign of dysfunction at both senior management levels and the board of directors. A large publicly traded company that relies for its success on the long term capital provided by major institutional

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[3] We note and welcome the fact that Tesla agreed to move to a majority vote standard for director elections in 2014.

[4] Ross Kerber and Tim McLaughlin, "Behind Tesla carnage, signs of support for Musk's SolarCity deal," *Reuters*, June 23, 2016.

[5] Liam Denning, "Tesla Plus SolarCity Equals 'No,'" *Bloomberg*, June 24, 2016. This loss in value was measured the day before the Brexit vote was announced.

[6] Steven Davidoff Solomon, "Tesla's Plan to Buy SolarCity Has Major Flaws," *New York Times*, June 22, 2016.

[7] Charley Grant, "Tesla: Incessant Cash Burn and Looming Competition Isn't a Trillion-Dollar Formula," *Wall Street Journal*, June 22, 2016.

investors such as the pension funds we work with must operate in a manner that provides greater stability and confidence.

The core problem with Tesla's governance is the continuing dominance of the board by Mr. Musk

There is widespread agreement that Mr. Musk is a brilliant and innovative entrepreneur. This is a significant reason why we as long-term investors have been willing to back Tesla's effort to develop sustainable alternative forms of energy and transportation. At the same time, our substantial experience with many companies in a wide range of industries has made clear to us that entrepreneurs, no matter how talented, cannot manage a large publicly traded corporation such as Tesla alone. In the very early days of a new company it is understandable that a dynamic founder like Mr. Musk will play a dominant role across the organization. However, over time, leadership and responsibility must be shared by a wider number of individuals and across a larger number of internal structures. In particular, once a company becomes public it must form a credible, accountable and thoroughly independent board of directors so that outside stockholders, who lack the time and resources to monitor in detail the activities of the company, are confident that their interests are being protected.

While Tesla maintains in its most recent Proxy Statement that the board meets the formal "independence" requirements of the NASDAQ listing standards,[8] we are concerned that Mr. Musk continues to dominate the board and sits at the heart of a complex web of relationships among board members and other companies controlled by him and/or family members. At Tesla itself there are multiple ties between the non-executive directors and Mr. Musk or his related companies. The Proxy Statement describes several of these links. These links can become conflicts of interest or even give rise to self-dealing behavior when transactions like that proposed with SolarCity are undertaken. Such conflicts and behavior put at risk the ability of those directors to engage in the independent judgment they must exercise as fiduciaries of outside stockholders.[9]

Here is a brief summary of the current relationships that create governance risks for stockholders:

<u>Elon Musk</u>

Mr. Musk is the founder, Chairman and CEO of Tesla. He is Tesla's largest single stockholder. He is also the founder, a director and the single largest stockholder of SolarCity. His cousin is the CEO of SolarCity. He is also a major investor in SpaceX where he has served as CEO, Chief Technology Officer and Chairman. Tesla has a number of ongoing business agreements with both SpaceX and SolarCity.

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[8] We do not necessarily believe that the listing standards themselves provide adequate protections for stockholders as they require the board to judge itself.

[9] We note that Tesla has recently adopted a so-called "forum selection" by-law provision which mandates that any legal action against the company take place in Delaware, where Tesla is incorporated. Delaware has strict standards that can trigger judicial oversight of transactions like the acquisition of SolarCity when there is a concern about unfairness due to a conflict of interest.

Kimbal Musk

Kimbal Musk is the brother of Elon Musk. He is also a director of SpaceX. He is a cousin of the CEO of SolarCity.

Antonio Gracias

Mr. Gracias is the lead independent director of the Tesla Board. He is the CEO, director and majority stockholder of Valor Management Corp. (“VMC”), an investment firm. VMC is an investor in SpaceX and Mr. Gracias is a director of SpaceX. VMC is also an investor in SolarCity and Mr. Gracias is a director of SolarCity. Mr. Musk and Kimbal Musk are investors in funds that are advised by VMC.

Stephen Jurvetson

Mr. Jurvetson’s venture firm Draper Fisher Jurvetson (“DFJ”) is a significant stockholder in SpaceX and Mr. Jurvetson is a director of SpaceX. DFJ is also a major stockholder in SolarCity and a partner of Mr. Jurvetson at DFJ is a director of SolarCity. Mr. Musk is also an investor in a DFJ venture fund.

Ira Ehrenpreis

Mr. Ehrenpreis is a manager of DBL Partners (“DBL”), another venture capital fund. He and DBL are investors in SpaceX. A partner of Mr. Ehrenpreis is a director of SolarCity in which DBL is also an investor.

Tesla’s board must be restructured to minimize serious governance risks to stockholder value

In particular, we are concerned that the current structure of the board makes transactions like the SolarCity acquisition more challenging for Tesla because of the increased risks associated with these kinds of conflicts of interest. Five of the seven Tesla board members have substantial and continuing relationships with SolarCity. A sixth, Brad Buss, is the former Chief Financial Officer, and likely still a stockholder, of SolarCity. This raises a serious question about whose interests the board is serving – the stockholders of Tesla or the stockholders of SolarCity.

Best practice in corporate governance would mandate in a situation where there is a conflict of interest that a committee comprised of directors who are not conflicted be formed to represent stockholder interests in negotiating a transaction such as the purchase of SolarCity. But that is clearly not possible in this case. Only one of the seven current directors, Robyn Denholm, has no (apparent) ties to SolarCity. Not only would the workload of carrying out this project be far too onerous for one director but it would be unreasonable to expect that director to maintain her objectivity given the conflicts that afflict the rest of the board.

We believe this situation to be similar to the circumstance in which a stockholder attempts to file a derivative lawsuit against a board for a violation of its fiduciary duty. The appropriate response of the board in that situation is to recruit new board members, who have no stake in the litigation matter, to form a “special litigation committee” empowered to examine the proposed litigation and act on behalf of the full board to respond to the litigation. The committee is given sufficient resources to hire independent legal counsel and, where necessary, financial advisors. This is an important measure of assurance to stockholders that the company responds appropriately to the issues raised by the litigation.

Similarly, here, we believe it is vital that Tesla immediately recruit two new board members to join with the one incumbent director, Ms. Denholm, who has no relationship with SolarCity, to form a “special transactions committee.” The committee should be empowered by the board to analyze Mr. Musk’s proposal to purchase SolarCity on an arms-length basis (including the hiring of independent legal and financial advisors). The committee should then report to the full board its recommendation with respect to the transaction. We believe the board should commit in advance to following that recommendation.

Conclusion

If followed, we believe this approach can improve the chances that Tesla will enhance stockholder value in its relationship with SolarCity rather than put it at risk. This single transaction, however, is only the most visible challenge now facing Tesla. To best manage future challenges we believe, as we suggested to Tesla in 2014, that the board should be permanently expanded, that the positions of Chairman and CEO be separated, that the board be declassified and that family members of Mr. Musk not serve on the board. We believe these are the minimal steps required to ensure that risk to shareholder value is minimized in the future.

We thank you for your consideration of these issues and look forward to your response to them as soon as possible.

Sincerely,

Dieter Waizenegger
Executive Director