Vanguard

Vanguard Investment Stewardship Insights

Redomestication and executive pay proposals at Tesla, Inc.

June 2024

Company: Tesla, Inc. (Tesla)

Meeting date: June 13, 2024

Proposal(s): Item 3: Approve the redomestication of Tesla from Delaware to Texas; Item 4: Ratify the 100% performance-based stock option award to Elon Musk that was proposed to and approved by our stockholders in 2018.

How the funds voted

At the 2024 annual meeting of Tesla, a U.S.-listed manufacturer of electric vehicles and energy generation and storage systems, the Vanguard-advised funds supported a management proposal to ratify the 2018 stock option award and a management proposal to approve the redomestication of Tesla from Delaware to Texas.[1]

The funds' proxy voting policies

As articulated in the funds' proxy voting policies, the Vanguard-advised funds evaluate compensation plans on a case-by-case basis, taking into consideration the facts and circumstances at the company in question. Compensation policies linked to long-term relative performance are fundamental drivers of sustainable, long-term returns for a company's investors. Providing effective disclosure of compensation policies, their alignment with company performance, and their outcomes is crucial to giving shareholders confidence in the link between executives' incentives and rewards and the creation of long-term returns for shareholders. We do not believe there is a one-size-fits-all approach to executive compensation, as the norms and practices for executive compensation vary by industry type, company size, company maturity, and region.

The Vanguard-advised funds are more likely to support compensation plans in which a majority of executive compensation remains variable, or "at risk," with rigorous performance targets set well beyond the next quarter. Some of the key considerations that we evaluate when reviewing executive compensation/remuneration include:

Alignment of pay and performance. The funds look for evidence of clear alignment between pay outcomes and company performance. This is mainly assessed through alignment of incentive targets with corporate strategy and analysis of three-year total shareholder return and realized pay over the same period versus a relevant set of peer companies. If there are concerns that pay and performance are not aligned, a fund may vote against a pay-related proposal.

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

Pay plan structure. Plan structures should be aligned with the company's stated long-term strategy and should support pay-for-performance alignment. Where the funds have determined that a plan's structure has led to, or could in the future lead to, pay-for-performance misalignment, a fund may vote against a pay-related proposal. For compensation structures that are not typical of a market, the Vanguard-advised funds look for specific disclosure demonstrating how the structure supports long-term returns for shareholders.

Governance of pay plans. The funds look for boards to have a clear strategy and philosophy on executive pay, utilize robust processes to evaluate and evolve executive pay plans, and implement executive pay plans responsive to shareholder feedback over time. The funds also look for boards to explain these matters to shareholders via company disclosures.

Analysis and voting rationale

In 2018, Tesla requested shareholder approval of a stock option grant for the CEO, which ultimately passed with majority support. The Vanguard-advised funds did not support the 2018 proposal given concerns related to the potentially significant relative magnitude of payouts linked to absolute, though ambitious, operating and market capitalization metrics. The funds were not supportive of these potential payouts because the CEO had the potential to receive significant rewards even if performance did not far outpace other companies.

At Tesla's 2024 annual meeting, the board sought shareholder ratification of the 2018 option award due to the Delaware Court of Chancery's January 2024 opinion that rescinded the award. Tesla also sought shareholder approval of a proposal to reincorporate the company from Delaware to Texas.

We evaluated the 2024 ratification proposal considering the current facts and circumstances related to the 2018 award, including the company's performance and shareholder returns since the 2018 grant. In our 2024 analysis of the performance award, which would grant Tesla's CEO approximately 300 million options (adjusted for stock splits since the initial grant date) given the achievement of a series of performance conditions, we noted that the company's performance and associated shareholder returns since 2018 have significantly outperformed the market and have been positive outliers. The company's total shareholder return was in the 98th percentile of all Russell 3000 companies from 2018 through 2023 and there are few companies that have created as much absolute market value appreciation as Tesla.

To further inform the funds' voting decisions, we met with Tesla executives and board members. During our engagement, board members reinforced their conviction regarding the importance of retaining the CEO and highlighted that the plan's five-year post-exercise holding requirement maintains the alignment of the CEO's economic interests with the company's shareholder base.

Our analysis, consistent with our concerns in 2018, found that the current value of this grant is a substantial outlier relative to CEO compensation levels of any potential peer group. That said, the unique circumstance of evaluating the plan retroactively eliminated our concerns that significant pay could be earned without company outperformance relative to the market or peers. Given the strong alignment of executive pay with shareholder returns since 2018 and the benefits the board asserted related to the motivational value for the CEO in preserving the original deal (which was approved by a majority of shareholders in 2018), the Vanguard-advised funds voted for the ratification of the CEO's 2018 option award at the 2024 annual meeting.

We also analyzed the board's recommendation of redomestication of the company from the state of Delaware to the state of Texas. While we note that there is some level of uncertainty regarding the implementation of a new system of business courts in the state of Texas beginning in the fall of 2024, we did not note material differences in shareholder rights between the state of Delaware and the state of Texas. We also reviewed the board's robust disclosures about its process around and considerations for the move, including Tesla's headquarters location and significant level of business activities in Texas, and the board's conclusion that redomestication in Texas is appropriate for the company. Therefore, noting that shareholder rights would not be materially impacted, the funds supported the redomestication proposal.

Vanguard publishes information regarding its voting and engagement activities, including the funds' proxy voting policies, Insights, and quarterly reports, to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our effort to provide useful disclosure of Vanguard's investment stewardship activities. We aim to provide clarity on Vanguard's positions on governance matters beyond what a policy document or a single vote can provide.

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