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CLIENT ALERT

Delaware Supreme Court Reinstates Tesla's Performance-Based Equity Award to Elon Musk

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On December 19, 2025, the Delaware Supreme Court, sitting *en banc*, reversed the Court of Chancery's rescission of Tesla's 2018 performance-based equity award to Elon Musk, holding that equitable rescission of the award was improper. The Court reasoned that equitable rescission requires a mutual return to the *status quo ante*, which would not be possible in this situation because Musk's full performance over six years could not be "unscrambled" and the stockholders had been rewarded for Musk's performance during that period. In addition, the Court held that the burden to propose alternative remedies to total rescission was on the stockholder plaintiff, not Tesla and Musk. The decision did not address the Court of Chancery's finding that Musk was a controlling stockholder. The Court awarded the stockholder plaintiff nominal damages of $1 and reduced the fees and expenses awarded to plaintiff's counsel from $345 million to $54.5 million, calculating such fees and expenses on an hourly basis with a 4x multiplier, an amount that had been previously proposed by Tesla.

The Delaware Court of Chancery's Opinion

In March 2018, a majority of disinterested stockholders approved Tesla's 2018 performance-based compensation package, which granted Musk twelve tranches of stock options that would vest only upon achieving certain market capitalization and operational milestones. By January 2023, after Tesla achieved the required milestones, all options had vested under the compensation package and were in the money. Following a five day trial in which a stockholder plaintiff challenged the performance-based equity award, the Court of Chancery held in a post-trial opinion that Musk acted as a controlling stockholder with respect to the award and applied "entire fairness" review based in part on director testimony that negotiations for the compensation package were not at arm's length. The Court of Chancery found the process and price for approving the 2018 compensation package to be unfair, and ordered rescission of the performance-based equity award, concluding that both Tesla's Board of Directors and Musk breached their fiduciary duties by approving the unprecedented compensation package.

Tesla and Musk responded to the Court of Chancery's ruling by forming a new committee of independent directors and soliciting a 2024 stockholder vote to ratify the same equity award that had been rescinded. At the same time, Tesla and Musk also solicited a stockholder vote to reincorporate Tesla in Texas. After a majority of Tesla's present and disinterested stockholders voted their shares in favor of the grant and reincorporation, Tesla and Musk moved to revise the Court of Chancery's opinion on ratification grounds. In December 2024, the Court of Chancery denied the motion, holding that it was procedurally improper for the defendants to raise the affirmative defense of stockholder ratification months after the court had already issued its post-trial opinion. The Court of Chancery further ruled that a post hoc vote cannot "cleanse" a conflicted controller transaction without protections for stockholders from the outset, and the proxy statement seeking ratification was materially misleading. In addressing plaintiff's request for attorneys' fees, the Court rejected plaintiff's request valued at approximately $5.6 billion and instead awarded a record setting $345 million fee, which equated to 15% of the grant date fair value of the rescinded compensation package.

The Delaware Supreme Court's Opinion

On appeal, the Delaware Supreme Court reversed the Court of Chancery's rescission remedy and reinstated the 2018 equity award, concluding that equitable rescission was neither feasible nor equitable because all parties could not be restored to their pre-transaction positions. The Court emphasized three points: (i) Musk's full performance over six years could not be "unscrambled," making restoration to the *status quo ante* impossible; (ii) Musk's preexisting equity stake was not consideration for the services rendered under the 2018 compensation package and therefore could not substitute to "restore" him; and (iii) the Court of Chancery erred in placing on defendants the burden to propose an alternative remedy to total rescission.

The Delaware Supreme Court underscored that equitable rescission requires a mutual return to the *status quo* and was an improper remedy because Musk would be uncompensated for his time and efforts performing for six years under the compensation package. The Court noted that there was no dispute between the parties that related tax or accounting matters and the dilution of Tesla's shares that was caused by approving the package could in fact be reversed, but held that the inability to restore Musk's years of compensated performance prevented rescission. The

Court further rejected as a justification for equitable rescission reliance on Musk's existing equity and the still-effective 2012 award as "past consideration".

With respect to the burden of proof, the Court emphasized that the plaintiff had the burden to establish entitlement to equitable rescission, including the ability to restore the *status quo ante*, and to establish grounds for any alternative remedies. In doing so, the Court rejected the Court of Chancery's determination that the defendants may have been entitled to partial rather than total rescission if defendants met their burden to propose a "delta" between an unfair and a fair award.

The Court awarded the plaintiff $1 in nominal damages, explaining that nominal damages are appropriate where liability is found, but that the record did not support any alternative remedial measures. It then awarded fees to plaintiff's counsel on a *quantum meruit* basis with a 4x lodestar multiplier, which was the amount that Tesla and Musk had previously argued to the Court of Chancery below would be appropriate.

Although Tesla and Musk also argued that the compensation plan had been ratified based on the 2024 stockholder vote and contested the Court of Chancery's holdings on entire fairness, the Delaware Supreme Court resolved the appeal solely on the rescission issue.

Key Takeaway

On the narrow issue addressed by the Delaware Supreme Court, the Tesla decision clarifies the scope of equitable rescission as a remedy and potentially renders performance-based equity awards more difficult to successfully challenge under Delaware law. More broadly, however, the decision left unaddressed some of the more debated aspects of the Court of Chancery's findings below, including Musk's role as a controlling stockholder and his involvement in the Tesla board's compensation deliberations, which had been the focal point of Musk's widely-reported campaign to relocate Tesla and his other companies outside of Delaware. The Court of Chancery's rulings in Tesla, in addition to certain other rulings from the Court of Chancery, in combination with Musk's campaign, led to a number of corporations seeking reincorporation outside Delaware, primarily to Texas and Nevada. That, in turn, led to legislative changes in Delaware to restore Delaware's preeminence as the jurisdiction of choice for the nation's corporations. It remains to be seen whether the Delaware Supreme Court's restoration of Musk's compensation package, albeit on narrow remedial grounds, will have any impact on corporations that are still considering exiting Delaware.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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