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Tesla / SolarCity: Governance Conflicts, Disclosure Shortcomings

If we alert you to existence of an undisclosed SEC probe, that means we filed a Freedom of Information Act (FOIA) request with the SEC on the company in question and have a response, in black-and-white, on government letterhead that supports our statement. Other interpretative guidance and disclosures appear below.

Analyst Summary: In the past we wrote of undisclosed problems found each at Tesla and SolarCity. Even if since resolved, which is not necessarily clear in the case of Tesla, some of the key players remain. To our view, prior undisclosed activities leave open the risk for governance conflicts and potential disclosure weaknesses today. With a proposed transaction on deck, revisiting upon our earlier reports all the more pressing. We include two of them here; one on Tesla, the other on SolarCity. We also include the disclosures regarding “Related Party Transactions” that appeared in the Tesla Proxy filed 15-Apr-2016. The overlap between Tesla and SolarCity is so significant as to reduce the term “arms-length” to little more than an unpersuasive, if not cynical, talking point.

Facts of Interest or Concern:

Tesla Motors (TSLA): We should have fresh data on Tesla soon. In the past, we found governance issues involving Tesla’s lead director, Mr. Antonio J. Gracias, who also serves on the board of SolarCity today. In Apr-2013, the Wall Street Journal reported Federal prosecutors had launched a criminal investigation into whether corporate directors were misusing government-sanctioned trading plans to sell company shares for investment funds they run. Tesla and its lead director, Mr. Gracias, were named in two related Wall Street Journal stories at the time (see [here](#) and [here](#)). Tesla and a company connected to its lead director were also reported to have each received subpoenas related to the investigation, according to the Journal.

According to the Tesla proxy filed 15-Apr-2016, in part,

“Antonio J. Gracias has been a member of our Board

of Directors since May 2007 and has served as our Lead Independent Director since September 2010. Since 2003, Mr. Gracias has been Chief Executive Officer of Valor Management Corp., a private equity firm. Mr. Gracias is a director of SpaceX and SolarCity. Mr. Gracias holds a joint B.S. and M.S. degree in ...”

On 24-Nov-2014, we had first alerted the market to the possibility that Tesla had an undisclosed SEC probe. Instead of speaking directly to the issues raised in our reports at the time, a company representative instead chose to ignore the questions and called our work “rumor and speculation”. The full text from the Tesla report we published on 20-Jan-2015 appears below.

SolarCity Corporation (SCTY): As of 16-Mar-2016, we received a response from the SEC to suggest an absence of recent SEC investigative activity at SolarCity. In the past, we did receive and published a note about documents from an SEC investigation of SolarCity which was undisclosed at the time. This probe, now closed, is from 2014. It pertained to matters that, in our opinion, should have been disclosed to investors.

On the next pages you will find the following –

- Our report on Tesla Motors, published 20-Jan-2015; pages 2-4.
- Our report on SolarCity, published 15-Jun-2015; page 5 .
- Excerpt from the recent proxy filing made by Tesla that shows an array of related party transactions and relationships between Tesla and SolarCity; page 6.

The following report on Tesla was originally published by Probes Reporter on 20-Jan-2015

Tesla Motors: Off the Watch List, But Important SEC-Related Questions Remain Unanswered

Tesla Motors, Inc. (TSLA): In Apr-2013 the Wall Street Journal reported Federal prosecutors had launched a criminal investigation into whether corporate directors were misusing government-sanctioned trading plans to sell company shares for investment funds they run. Tesla and its lead director were named in two related Wall Street Journal stories at the time (see [here](#) and [here](#)). Tesla and a company connected to its lead director were also reported to have each received subpoenas related to the investigation, according to the Journal.

- **Whatever came of those subpoenas sent to Tesla and the company of its lead director?**
- **Investors also ought to know what communications, if any, Tesla Motors, Mr. Elon Musk, any of his board members, and/or any of his entities, had with the SEC's Division of Enforcement in the past two years?**

These are simple questions. Today's report makes the case that they are two of the most important questions that investors and reporters should insist Tesla answer at this time.

When it comes to the SEC's Division of Enforcement the answer you always want to hear from Tesla, or any public company for that matter, is "none"; no contact. Any other answer calls for further explanation. Any non-answer, or one given without explanation, is almost certainly evasive.

Don't get your hopes up though. If recent history regarding our research is a guide, Tesla is good at being evasive and, to our view, far more comfortable peddling in disinformation and distraction than in providing substantive answers to reasonable SEC-related questions raised by investors and the media.

Background

On [24-Nov-2014](#), we first alerted the market to the possibility that Tesla had an undisclosed SEC probe. Instead of speaking directly to the issues raised in our report, a company representative instead chose to ignore the questions and call our work "rumor and speculation".

Tesla's "trash the messenger" dodge was parroted without challenge to the company or anyone ever contacting us about our report. See [here](#) and [here](#).

As a result of this deflection, Tesla got away (so far) with never actually explaining to the market why the SEC might find it necessary to cite law enforcement grounds as basis to deny public access to records regarding Tesla.

Why didn't Tesla just answer the question? In our experience, companies (or people) that play the "we don't comment on rumor and speculation" game do so for a reason: They don't want to answer the question. This time it worked.

Appeal Response Sharpens the Focus

We recently received a response from the SEC to an appeal we had filed about Tesla-related documents in which the SEC said, in a letter dated 29-Dec-2014, "... the investigative files identified by the FOIA Officer do not contain records responsive to your request."

This means Tesla Motors, the company, has no SEC investigation and is thus off our Watch List. It doesn't mean that investors are out of harm's way though. Remember, our request was focused on Tesla Motors, the company. We did not research Mr. Musk, his board members, or his ventures beyond Tesla Motors.

Based on comparing it to the hundreds of SEC appeal responses we've received through the years, the way the Tesla appeal response was written also tells us there is an investigation involving some person or entity in which Tesla Motors was incidentally mentioned or tangentially listed.

Every single time we report on a company's involvement in an undisclosed SEC probe, we can back it up with a response from the SEC – in black & white on government letterhead. As a matter of law, the SEC was acknowledging there was some sort of investigative activity somehow involving Tesla Motors. There is no rumor. This is not speculation.

The SEC did not back off from that position in the appeal response (which they have done in other cases). No error was spoken of. No investigation of the company was confirmed. No investigative file on a now-closed investigation was remanded back to the FOIA office for additional processing.

But here's the problem: The SEC also did not disclose the details on investigation(s) referenced above. We did, however, find a couple of news stories involving a prominent director of Tesla that are at least worth revisiting now.

Insider Trading Involving a Tesla Director?

In April-2013 the Wall Street Journal ran stories concerning potential insider trading by board members connected with certain public companies. An insider trading probe involving a public company director, whether or not disclosed, opens up many questions regarding corporate governance that could easily prove disruptive to both a company and its investors.

The following is excerpted from a [Wall Street Journal story of 25-Apr-2013](#) --

Antonio J. Gracias, the chief executive of a private-equity-fund operator called Valor Equity Partners LP, sits on the board of Tesla Motors Inc., a company in which Valor invests. [Emphasis added]

Valor set up a 10b5-1 plan in November 2011 and Mr. Gracias reported the sale of 927,205 of Valor's Tesla shares from March 9 through March 20, 2012, regulatory filings show. In those 11 days, Valor sold \$32 million of Tesla stock, more than half its stake.

Tesla's stock price soon got hit. Another investor in the electric-car company—the investment arm of the Abu Dhabi Water and Electric Authority—sold about \$100 million of Tesla stock on April 3. Within a week, Tesla's share price was 14.6% lower.

Valor sold an additional 29,800 Tesla shares in May, not reported as pursuant to a plan. [Emphasis added]

We then see the following, as excerpted [from the follow-up Wall Street Journal story of 30-Apr-2013](#) --

The U.S. attorney's office for the Eastern District of New York issued subpoenas requesting information from companies and funds cited in an April 25 page-one article in The Wall Street Journal that highlighted trading at three companies by directors who also run funds, a person familiar with the probe says ...

... Federal prosecutors sent subpoenas to two of three companies cited in last week's Journal article — Cardiovascular Systems Inc. and Tesla Motors Inc. —asking for documents and emails relating to the trading the article described ...

... Valor Equity Partners L.P., whose chief executive, Antonio Gracias, is on Tesla's board, received a subpoena relating to Valor's sale of Tesla shares in March 2012, days before the stock dropped amid the selling of shares by a large Tesla holder. [Emphasis added]

According to the [Tesla proxy filed 24-Apr-2014](#), Mr. Antonio J. Gracias is a prominent board member, holding the following positions on the Tesla Motors board: Lead Independent Director and member of the following committees: Audit;

Compensation; and, Nominating and Corporate Governance.

Mr. Gracias is up for re-election to the Tesla board this year. He also figures prominently across the Elon Musk empire.

Our Take

It is entirely possible the SEC responses to us on Tesla have absolutely nothing to do with Mr. Gracias. Further, we are not accusing him, anyone connected to him, or even Tesla, of having done anything wrong. The SEC activity here could be of a nature which investors might not even care about. Again, the SEC did not say. We can only ask reasonable questions and then follow the facts where they lead us. We then try to responsibly express opinion on what we find.

Given the facts, we think it entirely reasonable - if not prudent - to ask if Mr. Gracias and/or his company Valor Management have involvement in any investigation, including but not limited to allegations of insider trading of any kind. Mr. Gracias is so prominent on the Tesla board that you need to need to know if any such involvement exists.

Now before you dismiss this as "old news" consider this: 1) we've never heard of what came of the subpoenas sent to Tesla and Mr. Gracias' company; and, 2) insider trading probes can take a long time. This is true even when the accused are innocent or allegations against them are without merit.

In our opinion, if a public company becomes aware of law enforcement activity involving allegations of insider trading in any company's shares by one of its directors, especially in it's own shares; and, if such a company chooses to keep such information from investors, then your best course may be to run fast, and run far. This approach to corporate transparency does not establish a sense of trust.

If it turns out the allegations as reported by the Wall Street Journal and referenced here regarding Mr. Gracias have merit, in our opinion he needs to go. There can be no room for such behavior on any public company board.

What's the best way forward for investors? We recommend they insist Tesla answer directly the questions we posed at the open to today's report. Again, they are simple questions, calling for simple answers. It's time.

The following report on SolarCity was originally published by Probes Reporter on 15-Jun-2015

SolarCity (SCTY) In Aug-2014 the SEC confirmed ongoing enforcement proceedings that were and remain undisclosed by the company. The investigation over, we now know what it was about: Accounting problems that we think should have been disclosed.

The following is an excerpt from an SEC letter sent to SolarCity in Jun-2014 regarding its undisclosed SEC investigation –

**SolarCity's Undisclosed SEC Probe
Excerpt from SEC Letter to SolarCity
June 27, 2014**

C. Documents to be Produced

1. All DOCUMENTS provided by SOLARCITY to E&Y CONCERNING the statement in SOLARCITY'S SEC Form 8-K dated March 3, 2014 that certain of SOLARCITY'S previous SEC filings "should no longer be relied upon as a result of an error in the allocation of overhead expenses."
2. All DOCUMENTS CONCERNING any whitepapers (or other explanatory memoranda) provided by SOLARCITY to E&Y related to noncontrolling interests in subsidiaries as noted in SOLARCITY'S SEC Form 8-K dated March 18, 2014.
3. All DOCUMENTS summarizing the four material weaknesses identified in SOLARCITY's Sarbanes Oxley Section 404(a) review and/or audit as noted in SOLARCITY'S SEC FORM 10-K dated March 18, 2014 and/or SOLARCITY'S earnings conference call on March 18, 2014.

Related Party Transactions that appear in the Tesla Motors proxy filed 15-Apr-2016 –

SolarCity Agreements

We have entered into a number of agreements with SolarCity, including pursuant to requests for proposals and other objective selection processes by Tesla and/or SolarCity. Elon Musk, our Chief Executive Officer and Chairman, is a significant stockholder of SolarCity and has been its Chairman since July 2006. Jeffrey B. Straubel, our Chief Technical Officer, is also a member of the board of directors of SolarCity. In addition, certain other members of our Board of Directors have interests in SolarCity as described in more detail above in “Corporate Governance — Director Independence.”

We have entered into various arrangements to supply SolarCity with our energy storage products for its applications, including integrating such products with solar panels to create stationary power sources for sale or lease to residential and commercial customers. From time to time, SolarCity has issued individual purchase orders for such purchases from us. During fiscal year 2015, we recognized approximately \$2.4 million in revenue for sales of previous-generation energy storage products to SolarCity pursuant to such purchase orders.

In April 2013, we entered into a supply agreement with SolarCity under which we supplied SolarCity with previous-generation energy storage products. We recognized approximately \$0.7 million in revenue from SolarCity during fiscal year 2015 for energy storage products we supplied to SolarCity pursuant to this supply agreement. We do not anticipate recognizing any further revenues under this supply agreement.

In December 2015, we entered into a master supply agreement with SolarCity that governs SolarCity’s purchase of second-generation energy storage systems from us pursuant to purchase orders issued during 2015, and creates a framework under which SolarCity may purchase further Tesla energy storage products in 2016. We recognized approximately \$4.9 million in revenue from SolarCity during fiscal year 2015 for sales of energy storage products governed by this master supply agreement, and anticipate recognizing approximately \$44.0 million in such revenues during fiscal year 2016.

Also in December 2015, pursuant to a competitively bid process, we selected and entered into three power purchase agreements with SolarCity, pursuant to which SolarCity will design, build, own and operate solar panel systems at three of our facilities in California, and Tesla will purchase electricity generated by those systems for use at those facilities, at costs that are expected to be lower than would be available from the applicable public utility company. Two of such agreements have terms of ten years, and one such agreement has a term of 20 years, in each case corresponding to the lease term of each facility, and we estimate that the total amounts payable by Tesla over their respective terms will be approximately \$2.0 million, \$2.4 million and \$8.4 million, respectively.

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Notes: *The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced. The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security. New SEC investigative activity could theoretically begin or end after the date covered by this latest information which would not be reflected here.*

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