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SOME THINGS FOR EXECUTIVES TO BE ON THE LOOKOUT FOR IN 2020

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In 2019, we witnessed the precipitous decline in value of WeWorks, as well as supernovas of other startups that investors considered to be shooting stars. Aside from increased scrutiny of founder financial projections, one potential casualty of these miscalculations, and something to look for in 2020, may be a reduced willingness on the part of investors to agree to dual classes of stock that allow founders to have voting control through ownership of shares with enhanced voting rights.

Below are some other developments that executives may want to keep an eye on in 2020.

PROPOSALS BY DEMOCRATIC PRESIDENTIAL CANDIDATES

Two of the current front runners for the Democratic nomination, Senators Elizabeth Warren and Bernie Sanders, have proposed legislation specifically directed at executives.

On April 3, 2019, Senator Warren introduced the Corporate Executive Accountability Act, which would allow prosecutors to seek fines and jail time for executive officers of corporations with more than $1 billion of annual revenue who are found to have negligently permitted or failed to prevent the corporation from having violated the law. This legislation is in addition to Senator Warren's proposals to break up large tech companies and impose a wealth tax.

Senator Sanders announced on September 30, 2019, what he termed his Income Inequality Tax Plan. This proposal imposes additional income taxes on companies (both publicly and privately held) with revenues of more than $100 million if the ratio of the compensation of the company's CEO to the company's median worker compensation exceeds 50-to-1. Under the proposal, the company's corporate income tax rate increases as the compensation ratio increases. The proposal is a follow-on to the Dodd-Frank Act legislation, which requires larger public companies to disclose the ratio of the compensation of the company's CEO to the median compensation of its employees. Final regulations for these disclosure requirements were issued by the Securities and Exchange Commission in 2015. Senator Sanders, like Senator Warren, is backing a wealth tax.

PENDING LITIGATION

There are a number of pending lawsuits, which may be decided in 2020, that are of potential interest to executives. Here are a few.

Hertz Clawback Litigation

The Hertz Corporation has filed lawsuits against its former CEO and several other former officers seeking recovery of incentive compensation and damages arising from the restatement of its financial statements. This sort of recovery or "clawback" claim, which is relatively unusual, is also noteworthy in other respects.

The damages being sought by Hertz are based upon alleged misrepresentations made by the former officers in termination agreements they entered into with Hertz. Those representations included statements that the officers had not "engaged in any conduct that constitutes willful gross neglect or willful gross misconduct" with respect to their employment duties. Rather than pointing to specific acts of inadequacy or misbehavior, Hertz is basing its position on allegations of generalized insufficient management oversight and control.

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The Hertz litigation also involves the question of whether the former officers' indemnification rights under the company's bylaws, which include the right to payment of their legal fees, apply when the fees are incurred in connection with the defense of the types of claims asserted against them by Hertz.

The former officers persuaded a Vice Chancellor of the Delaware Chancery Court to have their legal fees incurred in connection with the lawsuits advanced on the ground that they were defending claims that arose from their work as officers and therefore were covered by the wording of the bylaws' indemnification and advancement provisions. Depending on the outcome of the litigation, the former officers may be required to repay the advanced fees. The decision stands as a reminder of the importance of clearly delineating in bylaws that indemnification does not extend to the cost of defending company clawback claims.

Tornetta v. Musk

This case is not only interesting because it involves Elon Musk, and a compensation package with a potential value of $56 billion, which Tesla Inc.'s board of directors approved for him in 2018, but also because it raises significant questions under Delaware law about the process that a board of directors must follow when setting the compensation of a controlling stockholder.

Although Musk's compensation was approved by Tesla's board and then ratified by Tesla's stockholders, the Delaware Chancery Court denied Tesla's motion to dismiss a lawsuit challenging the compensation, and in so doing, rejected the company's and the board's contention that these steps entitle the board to have its decision to authorize the compensation reviewed under the business judgement rule. Instead, the court said that the decision must satisfy the less deferential entire fairness standard.

The Chancery Court,[1] in what is a matter of first impression, held that the standard used to evaluate certain transactions involving a controlling stockholder should be applied to evaluate the compensation paid to a controlling stockholder. Under that standard, according to the court, a board of directors' compensation decision will avoid ''judicial second-guessing'' if it is approved both by an independent committee and by an ''informed, uncoerced vote of the majority'' of the stockholders who are unaffiliated with the controlling stockholder. The Tesla board's decision did not satisfy these requirements.

Litigation Challenging California's Board Gender Law

Beginning in 2020, a California law enacted in 2018 (SB 826) requires publicly traded companies, which have their principal executive offices in California (whether or not the companies are incorporated in California) to have a specified minimum number of women on their board of directors. Two lawsuits are seeking to overturn this law on various grounds, including that it violates the equal protection clause of the Fourteenth Amendment of the U.S. Constitution.

POTENTIAL IMPACT OF THE §4960 TAX ON EXCESS COMPENSATION ON COMPANIES THAT HAVE PRIVATE FOUNDATIONS

Section 4960, which was added to the Code by the Tax Cuts and Jobs Act,[2] imposes an excise tax — currently set at 21% — on tax-exempt organizations that pay excess remuneration to covered employees.[3] Excess remuneration is defined as annual remuneration of more than $1 million.

In determining whether an employee of a tax-exempt organization has received remuneration in excess of $1 million, remuneration paid by organizations, including both nonprofit and for-profit organizations, which control or are controlled by the tax-exempt organization, is taken into account.

It is common for successful for-profit companies to establish tax-exempt private foundations and to request that officers or other key personnel of the company serve as officers of the foundation. If the officers of the foundation are viewed as employees of the foundation, because the for-profit company controls the foundation, the compensation paid to the officers by the for-profit company will be included in measuring whether they have more than $1 million of remuneration for purposes of §4960.

A number of commentators have raised concerns that, even though the officers of the foundation may be acting as volunteers and not receiving any remuneration from the foundation, their status as officers may nevertheless result in them being treated as employees of the foundation, thereby triggering the aggregation of their for-profit company remuneration.[4] The potential outcome of this aggregation in the case

[1] *Tornetta v. Musk*, 2019 BL 354184 (Del. Ch. Sept. 20, 2019).

[2] Pub. L. No. 115-97. Unless otherwise indicated, all section references herein are to provisions of the Internal Revenue Code of 1986 (the ''Code''), as amended, and the regulations promulgated thereunder.

[3] ''Covered employees'' are defined generally as the five highest paid employees of a tax-exempt organization in any year beginning after December 31, 2016, taking into account remuneration paid not only by the tax-exempt organization but also remuneration paid by organizations, which are controlled by or under common control with the tax-exempt organization.

[4] See, for example, comment letter from the America Benefits Council (Apr. 2, 2019).

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of an officer who is paid more than $1M by the for-profit company is the imposition of the 21% tax on the for-profit company. Hopefully, the IRS will provide guidance in 2020 clarifying how §4960 is to operate in this setting.

CHANGES TO THE REQUIRED MINIMUM DISTRIBUTION RULES

On December 20, 2019, President Trump signed a spending bill, attached to which was the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019.[5]

The SECURE Act makes a number of revisions to the operation of employer retirement plans. Two provisions of the Act, which modify the so-called required minimum distribution (or RMD) rules, impact personal tax planning.

By way of background, as is generally well-known, individuals with amounts held in §401(k) and other employer-sponsored retirement plans and in individual retirement accounts (IRAs) are generally required to take minimum annual distributions from those plans and accounts once they attain age 70½. The RMD rules also mandate minimum annual distributions following the death of the individual.

The SECURE Act provides good news by raising the RMD commencement age from 70½ to 72 for individuals who attain age 70½ after December 31, 2019.

On the other side of the ledger, the SECURE Act removes a widely-used wealth enhancement planning technique. Prior to the SECURE Act, it was possible for an individual who named a child or grandchild as beneficiary of their IRA to have the amounts in the IRA paid out over the child's or grandchild's life expectancy—what had been referred to as creating a "Stretch IRA."[6]

The SECURE Act undid this deferral opportunity by requiring that all amounts held in an IRA at the time of the IRA owner's death be distributed within 10 years. This change, which for the most part is applicable to individuals who die after December 31, 2019, is subject to a number of exceptions, including where the beneficiary is the spouse or minor child (but not minor grandchild) of the IRA owner.[7]

IRA beneficiaries need not receive any particular amount of payment during any one year in the 10-year period, but may, for example, defer the entire payment until the 10th year. Judgments will need to be made, based upon the amount of the inherited retirement savings, age and income tax bracket of a beneficiary, as to whether it is better to defer payment of the inherited amount or take periodic payments during the 10-year period. Consideration should also be given as to whether it is advantageous for the holder of an IRA to incur the up-front tax cost of converting some or all of the assets of an IRA to a Roth IRA. Although the 10-year limitation applies to Roth IRAs, the beneficiary of a Roth IRA would be able to defer any payment from the IRA for the full 10-year period and then receive the payment tax-free.

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[5] Pub. L. No. 116-94.

[6] Post-death extended payouts were also available for benefits under a §401(k) or other employer retirement plan if the plan's provisions allowed for such distributions.

[7] *See* §401(a)(9)(H), §401(a)(9)(E).

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