PERSPECTIVES

SCHERER SMITH & KENNY LLP
THE STRENGTH OF PARTNERSHIP

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Scherer Smith & Kenny LLP serves mid-sized and fast-growing entrepreneurial companies. From complex litigation to business, real estate, intellectual property and employment law, our team brings strategic thinking, pragmatism and intense dedication to our clients' success.

New Of Counsel Joins Scherer Smith & Kenny LLP

We are pleased to announce that Joseph Ferrucci, a certified specialist in estate planning, has joined our firm as of counsel. Joe is a 1995 graduate of Yale University, cum laude, and obtained his law degree from UC Hastings in 2006. He also holds a Certificate in Estate Planning and Masters in Taxation from Golden Gate University.

Joe's broad estates and trusts practice, which spans both revocable and all forms of irrevocable trusts, wills, powers of attorney, health care directives and other estate planning instruments, fits well into the estates and trusts department's work here at Scherer Smith & Kenny LLP. We hope that you have the opportunity to meet Joe soon and are delighted at his becoming a valuable member of our team.

Employer Alert - Effective January 1, 2017: Minimum Wage Update for Employers With 25 or More Employees

In these beginnings months of 2017, employers should be aware of upcoming wage-and-hour compliance issues. In our July, 2016, Perspectives article *Implications of New Federal Exemption Compensation Rules*, we discussed the United States Department of Labor's ("DOL") finalized rule, effective December 1, 2016, that expands overtime protections to more workers ("***Federal Exemption Rule***") and California Senate Bill 3 ("***SB 3***") that sets forth a schedule for step increases in minimum wage up through January 1, 2022. This "alert" serves as a reminder and an update about these laws.

Federal Exemption Rule

In This Issue

William Scherer

Well, here we are again two months or so into the new year, full of promises, challenges, opportunities and surprises. I'm always game to start the new year, make my resolutions, and set some goals, but I also often look back on all the work and focus that

Federal Exemption Rule

The most important take-away from the Federal Exemption Rule is that exempt employees must be paid a minimum annual salary of $47,476 as of December 1st. However, due to a nationwide injunction recently issued by a United States District Court in Texas, the Federal Exemption Rule is not yet in effect. Rather, the injunction is currently under appeal by the United States Department of Justice. It is unclear when this appeal will be decided though it may be several months or longer. Ultimately, Trump's administration may significantly impact (or eliminate) the Federal Exemption Rule. Nonetheless, for now, employers do not need to comply with the Federal Exemption Rule.

Scherer Smith & Kenny LLP will continue to update our clients on these and any other important employment law developments.

California Minimum Wage Changes

Effective January 1, 2017, SB 3 increases the minimum wage to $10.50 for ***employers with 25 or more employees***. For employers with 25 or less employees, these employers will not be subject to the increased minimum wage until January 1, 2018. Of course, all employers, regardless of size, must continue to comply with applicable local minimum wage laws, such as San Francisco and Oakland, among others.

In addition to increasing the minimum wage for non-exempt/hourly employees, SB 3 has a collateral impact on exempt employee salaries. Effective January 1, 2017, exempt employees for employers with 25 or more employees must earn a minimum annual salary of $43,680.00.

While a new year brings many new opportunities, it also brings new uncertainties and compliance issues for employers. Employers with 25 or more employees should review their payroll to ensure (a) that all nonexempt employees are earning at least $10.50 per hour and (b) that all exempt employees are earning a salary of at least $43,680.00.

Please contact Denis Kenny at (dsk@sfcounsel.com), Ryan Stahl at (rws@sfcounsel.com), or John Lough, Jr. at (jbl@sfcounsel.com) for more information on upcoming laws that may affect your workforce, scheduling a mandatory harassment training, or assessing and updating your workplace policies to ensure compliance with controlling law.

- *Written by John Lough, Jr.*

PEAKS AND PITFALLS OF EQUITY CROWDFUNDING - Is it right for you?

Most everyone is now familiar with the term "crowdfunding," or a method of raising money by collecting small contributions from numerous people via an online platform. This "person-to-person" lending concept allows start-up companies with dreams of realizing a venture (but no alternative means to finance said venture), to solicit

went into the prior year and find it amusing that - at least at the New Year - all the past effort is somewhat discounted. The curtain drops on 2016 and all eyes focus on the horizon. We total the credits and debits in our personal and business experiences, compare them against the following year's budget, find out where we can do better, and plow on.

Societally it seems that what matters is what's ahead - goals and aspirations - rather than what has occurred in your personal, financial, and emotional life. When you think about it, if you use the end of the year essentially as a forecasting and budgeting tool, the end of the year is completely arbitrary - December 31st might just as well be August 23rd� or the beginning of October, or any other random day.

The trick, of course, is not to fall into the trap of discounting the year as we look ahead, but to consciously build upon the learnings of each passing year and add it to our collective experiences. It helps to embrace the essential reasons for the new year in order to recapture its wonder, promise and purpose. In a more agrarian past, nature's seasonal donations from strangers on the Internet in exchange for some special return on their investment.

Prior to the JOBS Act of 2012, a typical return on an investment might be a free product or service (or the ability to provide input into the development of a product or service), but it would not net the investor a direct equity stake in the soliciting company. The issuance of stock in exchange for a crowdfunding investment was effectively prohibited by federal securities law as the SEC only allowed the issuance of stock to "accredited investors," as defined in the Securities Act (typically those with a net worth of over $1,000,000 or individuals meeting certain annual income thresholds).

In response to its increasing popularity as a fundraising approach, the JOBS Act of 2012 added a caveat (in the form of an exemption from securities registration) that would allow companies to offer and sell equity to the general public over crowdfunding sites, essentially by removing the requirement that investors in crowdfunding campaigns be "accredited." (See, Securities Act, Section 4(a)(6)).

Effective May 16, 2016, the legislation, formally titled "Regulation Crowdfunding," allows eligible companies to raise up to $1,000,000 over a twelve-month period. Investors are permitted to contribute up to $2,000 or a set percentage of their annual income or net worth (5% if an investor's annual income or net worth is below $100,000 and 10% if it is above $100,000). The transactions are permitted to take place over online crowdfunding platforms, subject to certain restrictions on advertising and disclosures, which were instituted to protect investors.

Despite having been effective for nearly 8 months, the jury is still out on whether this new form of "equity crowdfunding " is ultimately a suitable alternative for small and emerging companies to raise seed money in exchange for stock.

As counsel to small and emerging companies, we understand that many of our start-up clients may be asking themselves whether equity crowdfunding is a viable fundraising option for them, and this article aims to address some of the pros and cons of this approach.

Pros

There are many upsides to crowdfunding. First and foremost, crowdfunding gives the company the ability to raise money when other opportunities might not otherwise be available (such as angel investors, wealthy friends or family, or VC firms). Another upside is that founders may be able to retain significant ownership over their company by issuing small amounts of stock to many different investors whereas more traditional financings typically require that investors receive a large amount of equity. In addition, because individuals investing in a company via crowdfunding campaigns do not have to be highly sophisticated, their investments typically do not come with the same strings and demands that are attached to

nature's seasonal rhythm, the promise of longer days, and the start of the new planting cycle made the end of December a natural point of demarcation for the new year.

My mother's family were pioneers who walked and pulled their oxen across the nation from East to West, stopping each generation on the way to stop, clear, and farm a plot of land for some years, before finally reaching California in the 1850s. My grandmother told me that pre-electrification winter was truly a time of rest and family, a time when little work was done, you slept through the darkness, and sat around a fire in the evening to commune and reflect, until finally being summoned by longer days and higher temperatures to begin getting ready for the planting season. In a natural world in which man had little control the new year nudged the collective effort after spending several months of relative rest and reflection after the harvest.

2017 has a number of promises and challenges that I look forward to. But I also want to celebrate the past year, which was so rich and filled with family, friends and loved ones. And I will be able to more deals involving VC firms or sophisticated investors. This allows the company a lot more freedom in defining the terms of the investment, and could significantly speed up the fundraising process.

Another benefit lies in the potential for greater public relations exposure for the company. This is not only because the financing campaign will be available on the Internet (increasing the company's visibility), but also because the campaign ultimately expands the network of individuals involved in the company. This may in turn bolster the company's social media presence (through increased word of mouth), and generate more publicity in the company's community than would otherwise come from a traditional financing round with limited sophisticated investors, whose investments may be kept confidential.

Cons

Of course, there are downsides.

First, the reporting requirements imposed by Regulation Crowdfunding are onerous. The SEC requires a company intending to use equity crowdfunding to file comprehensive documentation before making a securities offering, which includes detailed information about the corporate structure of the company, business plans, and financial data, all of which information is made publicly available. This information must be updated at a minimal annually, but also whenever there are any material changes to the investment. An experienced accountant should be used to create the financial reports required by the SEC in order to avoid penalties for erroneous information and reporting, which will certainly come with a hefty price tag. In addition, there are typically platform use fees of roughly 7-12% of the money raised and payment processing fees of roughly 3-5%. It goes without saying that these significant reporting requirements will result in higher administrative costs for the company.

Second, the restrictions on the amount of individual contributions, as well as the overall investment ceiling imposed by Regulation Crowdfunding, may also be a problem. As noted above, there is a $1,000,000 cap on proceeds in a 12-month period, which may be prohibitively low for some companies. In addition, because individual investments are also limited, the more money a company needs, the more shareholders they will need to acquire. This results in a crowded cap table, which is difficult to manage and can be administratively burdensome on a small company.

Finally, if and when the company desires to expand or raise more money, sophisticated investors may balk at investing alongside numerous unknown and unsophisticated shareholders. As a result, utilizing Regulation Crowdfunding at the outset might ultimately impede a company's ability to bring in growth capital later, and could stall operations.

Conclusion

be able to more thoroughly enjoy this year by folding into it the experiences of the past. I try actively to think about and include those experiences, both the ones I want to repeat and those I want to avoid, in making the decisions of how I live this year. I look at the newest year as a repeat of certain rhythms of the past, but with the overlay of these additional life experiences. It makes this next trip around the sun, and the ones that will follow, so much richer.

- *Written by William Scherer*

Careful thought should always be put into raising capital. Though equity crowdfunding is an attractive alternative to traditional financing, small and emerging clients must consider whether this approach will provide the appropriate platform for the company's particular growth model. It may be that the downsides (reporting requirements, cost, cap table management issues, etc.) ultimately outweigh the benefits of easier money.

If you are considering equity crowdfunding as means of raising capital, or would simply like to discuss the pros and cons of equity crowdfunding in more detail, please feel free to contact Heather G. Sapp, Esq. (hgs@sfcounsel.com) , or Brandon D. Smith, Esq. (bds@sfcounsel.com) of Scherer Smith & Kenny LLP (www.sfcounsel.com). As always, we are here to assist you in developing an approach that works best for your business.

- Written by Heather Sapp

Joint Employer Update

I have written many articles and frequently speak at seminars and webinars concerning the increasingly widely-publicized legal arena known as independent contractor/1099 ("IC") misclassification. IC misclassification is the moniker used to describe the situation when a hiring party (an individual or a business) erroneously treats a worker (an individual or a business) as an IC instead of an employee. The legal ramifications of IC misclassification are immense and include damages (e.g., unpaid wages, meal and rest period premiums, and healthcare and retirement plan/401k benefits), penalties (e.g., payroll taxes, prejudgment interest) and attorneys' fees and costs, among other expenses.

The U.S. Department of Labor (the "DOL") has recently attempted to educate the public about avoiding IC misclassification. These education efforts include the August 2016 issuance of a publication entitled Misclassification Mythbusters, which cites twelve "myths' which the DOL explains are commonly cited by hiring parties and workers alike as reasons for IC classification. The DOL proceeds to correct and educate the public by providing the real "facts" concerning each of these myths.
See https://www.dol.gov/whd/workers/Misclassification/myths.htm

Misclassification Mythbusters follows by just over one year the July 2015 issuance of an Interpretation by the Administrator of the DOL Wage and Hour Division dealing with IC misclassification (the "Interpretation").
https://www.dol.gov/whd/workers/misclassification/ai-2015_1.htm.
The Interpretation is a much more comprehensive and, many would say, convoluted treatise covering a number of areas in addition to IC misclassification including a focus on the prevalence of "exempt" employee misclassification. The usefulness of the Interpretation as an educational tool has also been widely questioned as its content seems more appropriate for an audience of experienced employment law attorneys and scholars than the general business public. Nonetheless, the DOL's decision to issue, within just one year, two IC misclassification-specific publications, highlights the

critical import of IC misclassification in our current legal landscape. Whenever the government attempts to explain its laws, the public should be concerned. The IC misclassification legal arena provides a fitting reason to be concerned.

A fundamental lesson evident from the current IC misclassification legal arena is: proceed with utmost care before retaining any IC. Instead of following the DOL's path of trying to understand and apply the various "myths" and "facts" surrounding IC misclassification, I suggest you accept the following assumption for any hiring decision: a worker will be considered your employee unless you can prove otherwise, not vice versa.

Start by asking yourself the following discrete questions: am I (1) hiring an outside business (2) to perform a discrete, specialized task or set of tasks (3) which I am not otherwise able or which may not be suitable for my existing staff to handle in-house? If your answers to any of these three basic questions is, no, you better not choose IC classification. If your answers are primarily, yes, then you ***may*** be on the right track toward viable IC classification ***but*** you still need to consider a number of other factors before making a definitive decision.

Examining and explaining the application of the various IC/employee factors, indicia and tests which differ (sometimes widely) from agency to agency and jurisdiction to jurisdiction is outside the scope of this brief article. Suffice to say, one test

definitely does not fit all. This reality, again, demonstrates the importance of consulting with trusted counsel before diving into the potential pitfalls of IC engagement and misclassification.

We at Scherer Smith & Kenny LLP remain available to assist you with any employment-related or other legal issues. Please contact Denis Kenny (dsk@sfcounsel.com), Ryan Stahl (rws@sfcounsel.com), or John Lough (jbl@sfcounsel.com) for more information.

-Written by Denis S. Kenny

Employment Law Updates: Rest Breaks and Choice of Law/Forum Provisions

The beginning of any year brings a flurry of legal developments and an opportunity to review one's employment practices and policies. In the closing days of 2016, the California Supreme Court issued its opinion on rest breaks in *Augustus v. ABM Security Services, Inc.* (Dec. 22, 2016) 2 Cal.5th 257, where the Court concluded that state law prohibits on-duty and on-call rest periods / breaks.

In another important development, California enacted Labor Code Section 925 which prohibits California employers from requiring California employees to have employment disputes resolved under non-California law or in a non-California venue/forum.

This article will discuss both *Augustus* and Labor Code Section 925 in more detail below.

Rest Breaks Must Include Ten Uninterrupted Minutes

In recent years, wage and hour issues under the California Labor

In recent years, wage and hour issues under the California Labor Code and Industrial Welfare Commission Wage Orders ("***Wage Orders***") have been heavily litigated, specifically, meal and rest break issues.

By way of background, in the 2012 decision, *Brinker Restaurant Corporation v. Superior Court* (2012) 53 Cal.4th 1004, 1034-41, the California Supreme Court defined the scope of an employer's obligation to provide non-exempt employees with uninterrupted, 30-minute meal breaks. Brinker, specifically, provides that the employer does not need to "self-police" make sure meal breaks are taken without interruption or ongoing work. Rather, the employer simply needs to relieve the employee from any duty and relinquish any control over the employee. (*Id.*) However, best practices still dictate that employers should require employees to clock out and in for each meal period taken. While *Brinker* answered many questions about how employers should handle meal periods, it did not address rest breaks.

The California Supreme Court waited until December 2016 to apply its *Brinker* meal break precedent to rest breaks. In *Augustus v. ABM Security Services, Inc.*, *supra*, the plaintiffs worked as security guards where the employer required them to keep their pagers and radio phones in service and with them at all times, including rest breaks. The plaintiffs claimed these on-duty requirements violated rest period requirements under the applicable Wage Order and California Labor Code � 226.7. The California Supreme Court ultimately agreed ruling that employers must "relieve their employees of all work-related duties and employer control during 10-minute rest periods. � A rest period, in short, must be a period of rest." (*Augustus*, *supra*, 2 Cal.5th at 834.)

Consequently, as with meal breaks, a valid rest break must be uninterrupted time during which an employee may leave the workplace. And, for every rest break that does not meet these requirements, an employer must provide the affected employee with (a) an additional rest period to replace the invalid one or (b) an additional hour of pay (the "meal period premium").

Prohibition of Non-California / Out-of-State Choice of Law and Forum Selection / Venue Provisions In Employment Agreements after January 1, 2017

State and federal laws frequently vary in the degree of protections afforded to employees. California is widely viewed as one of the most employee-friendly states in our country. For example, California requires employers to provide non-exempt employees with meal and rest breaks, but federal law (the Fair Labor Standards Act) and the laws of many other states do not. For these reasons, many California employers have historically included offer letter and employment contract provisions requiring California employees to resolve employment disputes under out-of-state laws or in out-of-state courts.

California public policy has long disfavored enforcing choice of law and venue/forum provisions that apply non-California law or require a non-California forum to resolve disputes involving California a non-California forum to resolve disputes involving California employees ("***Non-California Provisions***"). In applying this choice of law / forum selection analysis, California courts have engaged in a fact-intensive balancing of interests analysis to determine (1) "whether the chosen state has a substantial relationship to the parties or their transaction" or (2) "whether there is any other reasonable basis for the parties' choice of law." (*Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459, 466.) If either element is met, then the court determines whether the Non-California Provisions are contrary to a fundamental policy of California such that California has a "materially greater interest than the chosen state" in the subject matter of the dispute. (*Id.*) In those instances, the Non-California

Provisions will *not* be enforced. One notable example context in which California courts have consistently refused to enforce Non-California Provisions concerns California Labor Code wage and hour claims (such as meal and rest break and overtime pay violations) where California employees would effectively be required to "waive the unwaivable wage and hour protections the Labor Code provides to all California employees." (*Verdugo v. Alliantgroup, L.P.* (2015) 237 Cal.App.4th 141, 153.)

However, in practice, inconsistent results have led to ongoing uncertainty for employees and employers alike concerning the enforceability of Non-California Provisions. The California legislature's passage of Labor Code Section 925 seeks to remove such uncertainty. Now, for any employment agreements entered into, modified, or extended on or after January 1, 2017, Section 925 prohibits an employer from requiring an employee who resides and works in California to agree to (1) a forum/venue provision that requires the employee to "adjudicate [either litigate or arbitrate] outside of California a claim arising in California" or (2) a choice of law provision that "[d]eprives the employee of the substantive protections of California law with respect to a controversy arising in California." Interestingly, Section 925 makes the Non-California Provisions voidable by the employee rather than facially void. (*Id.* � 925(b).) This means the employee would need to object to the legality of the provisions before they may be found unenforceable as opposed to them being found automatically invalid.

Moreover, Section 925 provides an exception where an employee has legal counsel negotiating the terms of an employment agreement. In those instances, employees who have legal representation may agree to designate Non-California Provisions for those controversies arising from the negotiated agreement.

Nonetheless, before employers continue to require California employees to sign Non-California Provisions, employers should know that an employee who successfully opposes Non-California Provisions may be awarded reasonable attorney's fees, in addition to "injunctive relief and any other remedies available" (*Id.* � 925(c).)

Consequently, in most instances, California employers are advised to remove Non-California Provisions from standard offer letters, employment agreements and other legal documents executed with California employees.

Takeaways

When new laws are enacted and new court cases are decided, it is always a good idea to review current policies, handbooks, and agreements to ensure legal compliance. In these beginning months of 2017, employers should (1) ensure that they have a written meal-and-rest break policy and (2) review those policies in light of *Brinker and Augustus*. Further, for any new agreements entered into, modified, or extended on or after January 1, 2017, employers should review the choice of law and venue/forum selection provisions to ensure those provisions identify California law and courts, except under the limited circumstances outlined above.

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Written by John Lough, Jr. and Denis S. Kenny

Areas of Practice

Business; Real Estate; Intellectual Property and Employment Law;
Litigation and Dispute Resolution; Nonprofit; Estates and Trusts

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