PERSPECTIVES

SCHERER SMITH & KENNY LLP
THE STRENGTH OF PARTNERSHIP

140 Geary Street, Seventh Floor ▪ San Francisco, CA 94108-4635
Phone: (415) 433-1099 ▪ Fax: (415) 433-9434 ▪ www.sfcounsel.com

May 2012

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.

Upcoming Webinar

Denis Kenny will be co-presenting with Jason Posel, SVP, Strategy & Solutions of ClearPath Management- -a long-term and valued Scherer Smith & Kenny LLP client- -a webinar entitled: "Independent Contractor Classification: Recognizing your risks and how to manage them."

The webinar will be held on the following dates (click link for more information):

May 31st - 11am PST / 2pm EST
June 5th - 11am PST / 2pm EST

This webinar will:

- Cover the latest legislative issues regarding worker misclassification
- Evaluate the risks for misclassifying workers, including possible financial ramifications
- Examine ways to determine if a worker should receive a 1099 or a W-2
- Demonstrate key steps to prepare for an IRS/EDD audit or litigation
- Reveal best practices for engaging independent contractors (ICs) and other contingent workers

Given the recent surge in IC misclassification legislation and the attendant increase in audit and lawsuit-related exposure facing individuals and businesses who retain IC's, this webinar is particularly timely and geared toward the overall goal of teaching you to correctly classify your 1099 workers before the audits and lawsuits come to fruition.

Supreme Court Provides Guidance to Employers on Meal and Rest Periods

In This Issue

Upcoming Webinar

Supreme Court Provides Employers Guidance on Meal and Rest Periods

New California Law Requires Written Commission Agreement

Companies Breathe a Sigh of Relief After Amendment to Senate Bill 978

Raising Money For Your Startup Through Crowdfundng

Partner Notes

Bill Scherer

Earlier this week I was chatting with one of my clients – a lawyer – who is considering entering into partnership in an attempt to expand business. We spoke at some length about the various terms and conditions that he should generally want in the partnership

The California Supreme Court recently issued its long-awaited decision in *Brinker Restaurant Corp. v. Hohnbaum*. While the case involved a purported class of former restaurant employees and dealt with a host of issues, its decision was anticipated by employers and employees alike due to the Court's consideration of the requirements associated with meal and rest periods for non-exempt employees in California. Non-exempt employees are those non-managerial employees for whom wage and hour rules apply. The Supreme Court ultimately provided guidance on both of these issues as described in more detail below.

Rest Periods

In its decision, the Court first addressed the parameters of ten-minute break periods set forth in California Industrial Welfare Commission wage order number 5-2001 ("Wage Order 5"). In pertinent part, Wage Order 5 states as follows:

> Every employer shall authorize and permit all employees to take rest periods, which insofar as practicable shall be in the middle of each work period. The authorized rest period time shall be based on the total hours worked daily at the rate of ten (10) minutes net rest time per four (4) hours or major fraction thereof. However, a rest period need not be authorized for employees whose total daily work time is less than three and one-half (3 ½) hours. Authorized rest period time shall be counted, as hours worked, for which there shall be no deduction from wages.

Within this section, that Court was asked to consider two questions: (1) at what rate must rest time be authorized and permitted, and (2) when should or must such rest periods occur in a given work shift?

With respect to the first issue concerning the rate at which entitlement to rest periods accrues, the Court focused on the "major fraction thereof" language of Wage Order 5 as applied to the exception for employees who work less than three-and-one-half hours. In combining these two provisions, the Court held as follows: "Employees are entitled to 10 minutes' rest for shifts from three and one-half to six hours in length, 20 minutes for shifts of more than six hours and up to 10 hours, 30 minutes for shifts of more than 10 hours and up to 14 hours, and so on." Consequently, the phrase "major fraction thereof," in the Court's view, was meant to apply to the entire four-hour interval set forth in Wage Order 5 and not simply the last hour of such an interval.

Regarding the issue of when rest periods must be taken, the Court responded to an argument from the plaintiffs that "employers have a legal duty to permit their employees a rest period before any meal period." The Court found this argument to be without support, holding only that employers "insofar as practicable" must "make a good faith effort" to provide rest periods in the middle of each work period. Despite such guidance, the Court further indicated that deviations could occur and that, further, employees receiving two rest breaks due to the length of their work day should be able to take one break before a meal break and one after "as a general matter."

Meal Periods

Following its discussion of rest periods, the Court next addressed Wage Order 5's additional mandate that, under certain circumstances, employers have a duty to provide to employees a 30-minute meal period. The Court's analysis again began with specific language from Wage Order 5, which states as follows:

agreement before "tying the knot." Being a lawyer he is, of course, a suspicious sort, and so as we concluded our call, he rhetorically said, "So I should be protected with all of these terms?" I paused for a moment, and returning to the conversation, replied simply, "No." Hearing silence from my usually chatty friend, I continued: "The only thing that will truly protect you is understanding what you're creating, and committing to the obligations you're agreeing to down the road."

I do not mean through this short article to wax philosophically or expose some deep flaw within the practice of documenting agreements. Rather, I wish to stress the greater importance of "intent" over "content." This theme runs throughout my client experience: why is it that some well-funded clients struggle to find profit or even to survive, while some shoestring operations thrive and grow? It is my observation that a company's success is most reliant not on timing, product, service, financial resources - or worse, who sits on its advisory board. Instead,

> No employer shall employ any person for a work period of more than five (5) hours without a meal period of not less than 30 minutes, except that when a work period of not more than six (6) hours will complete the day's work the meal period may be waived by mutual consent of the employer and employee. Unless the employee is relieved of all duty during a 30 minute meal period, the meal period shall be considered an "on duty" meal period and counted as time worked.

As with rest periods, the Court addressed two threshold questions: (1) what exactly is the nature of an employer's "duty" to provide an employee with a meal period, and (2) what, if any, are the timing requirements applicable to when such a meal period, if mandated, must be provided?

With respect to an employer's duty to provide a meal period, the Court set forth three criteria an employer must meet. First, the employer must ensure the employee has at least 30 uninterrupted minutes for such a meal period. Second, the employee must be free to leave the employer's premises. Third, the employer must relieve the employee of all work duties for the entire meal period. With respect to this third element, the Court specifically noted that relief of work duties does not equate to "a duty to *prevent* . . . employees from working during meal periods" (emphasis added).

Regarding the issue of when a meal period break, if mandated, must be given during a certain shift, the Court again found unconvincing an argument made by the plaintiffs. In this instance, the plaintiffs argued such meal periods must be given at intervals no greater than 5 hours apart, thus entitling some employees who work longer shifts to a second meal period 5hours after a first meal period. The Court instead offered a much simpler and pro-employer interpretation: "[A]n employer's obligation is to provide a first meal period after no more than 5 hours of work and a second meal period after no more than 10 hours of work." Beyond this mandate, the Court left an employer free to determine *when* within such intervals an employee must be given such a meal period.

Additional Considerations

The Court's *Brinker* decision, while already being labeled as "pro-employer," provided partial victories for both employers and employees while leaving some aspects of California meal and rest period law unsettled.

With respect to specific guidance, the Court made clear that entitlement to additional rest periods after an initial shift of four hours comes after an employee works a "major fraction" of a second four-hour work shift – not a major fraction of the fourth hour of such a shift. This ruling is clearly pro-employee as an employee working 6 hours and 1 minute will be entitled to two rest periods under *Brinker*'s logic.

Conversely, the Court's ruling that an employer may provide a meal period whenever it wants before 5 hours of work has elapsed (and a second meal period at any time before 10 hours has elapsed) clearly provides greater flexibility to employers than the plaintiffs in *Brinker* desired. Such flexibility will obviously benefit employers in scheduling meal periods for employees working multiple shifts on a single work day by allowing them, for example, to provide a meal period at the beginning of an employee's afternoon work shift instead of having to wait until the middle or end of such a shift when such a break may be less feasible.

Other aspects of *Brinker*, however, remain more muddled. For example, while the Court issued a clear three-factor test regarding what an employer must do to comply with California's meal-period requirement, such a test offers little comfort or value to the employer who is forced to defend against allegations by an employee that – despite the existence of a policy meeting *Brinker's* requirements – a meal break was never actually provided. Further,

success relies on management. And I've always defined good management as communication designed to make sure the principals and employees clearly understand the company's focus, and that the public is made to clearly understand that focus.

As a result, I believe my most important role (and those of everyone here at Scherer Smith & Kenny) is not as the technocrat who cobbles together agreements. Instead, I much more feel that the most beneficial skill we, as attorneys, can bring to our clients – and a skill that often is largely discounted – is to be just nosy and interested enough in the client to make sure that the parties are truly committing to the effort and compromise that will be required to meet all that they have agreed to within the agreement.

Sure, comprehensive legal knowledge and an understanding of the provisions to be included in any agreement are important skills that require years of practice. And the joyous benefits of well-crafted agreements are profits and recognition. But you can have the best possible agreement collecting dust on the shelf, and nothing will come

while the Court appeared to offer some leeway on when a rest period may occur if not in the middle of a work period, the Court did not address what considerations might be legally sufficient to justify a deviation from a middle-of the-shift practice.

Ultimately, *Brinker*'s holdings will be refined though additional decisions and guidance from California administrative agencies. However, at a minimum, employers of non-exempt employees should ensure their current policies and procedures provide for meal and rest periods that comply with its mandates. Should you have questions about creating and implementing such policies or need assistance with updating current policies to comply with *Brinker*'s mandates, Scherer Smith & Kenny LLP remains available to assist you in these and any other employment-related matters.

Please contact Denis Kenny at dsk@sfcounsel.com for more information

- Written by Denis S. Kenny

New California Law Requires Written Commission Agreement

On October 7, 2011, California Governor Jerry Brown signed into law Assembly Bill 1396, which will affect employment agreements involving commissions as a method of payment. This new statute, codified as Labor Code Section 2751 and **effective January 1, 2013,** requires an employer doing business in California to enter into a written contract with any employee who receives commission wages as a method of payment for services to be rendered in the state. Given the nuances of this law, we thought it important to make you aware of it sooner than later to allow ample time to institute necessary changes to applicable policies and procedures.

Any commission contract will need to include the method by which the commission wages will be computed and paid. The employer must sign the contract, provide each affected employee a signed copy of the contract and obtain and retain in its files a signed acknowledgement of receipt from each employee.

In our view the most significant and onerous provision of the law provides that the contract is presumed to remain in force until the contract is superseded or employment ends, even if the commission contract expires by its own express terms during the employment term,. It will be interesting to see how the courts will interpret and enforce this part of the law since it raises more questions than answers including, for example, what would happen if an employer wishes to cease paying commissions altogether to a particular employee or group of employees (e.g. to address financial constraints) but does not want to terminate the employee (s). A strict reading of the statute would require that this type of compensation could only happen with the written approval of the affected employee(s) (to be included in a new contract which supersedes the old one). Therefore, if an employee refused to agree to the new contract, the employer would be faced with the Hobson's choice of either allowing the old commission contract to remain in place or terminating the employee. Either way, the law would certainly constrain employers' discretion to unilaterally change the terms and conditions of commissioned employees' compensation.

'Commission wages' are defined as "compensation paid to any person for services rendered in the sale of an employer's property or services and based proportionately upon the amount or value thereof." Cal. Lab. Code § 204.1. They do not include short-term productivity bonuses, nor do they include bonus and profit-sharing plans, unless there has been an offer by the employer to pay a fixed percentage of sales or profits as compensation for work to be performed.

of it until the people to the contract truly understand their part in successfully meeting the goal.

In all candor, one of my favorite pursuits as a lawyer is sitting across the table when the client steps away from the profit motive and recognizes the central importance that their own efforts will have in reaching profit and success. We here at the firm look forward to assisting all of you towards that goal.

- Written by Bill Scherer

Previously, California law required only those employers doing business in the state with no actual place of business in the state to enter into written employment contracts involving commission wages.

With the implementation of this law, California joins New York as states requiring written agreements. N.Y. Labor Law § 191(1)(c).

Please contact Denis Kenny at dsk@sfcounsel.com for more information.

- Written by Denis S. Kenny

Companies Breathe A Sigh of Relief After Amendment to Senate Bill 978

Many of you may have heard about SB 978. When originally introduced earlier this year it would have significantly impacted private companies who sell stock in California (such as to founders or investors). Currently, California requires that a stock offering made to California residents be "qualified" by the Commissioner, an often lengthy and expensive process. Technically even the initial sale of stock to founders falls under these requirements. Exemptions from qualification are available for certain securities and securities transactions, thereby allowing a company to comply with the securities laws on a faster and less expensive basis. A common exemption is under Section 25102(f) of the California Corporations Code, which requires a company to file a Notice of Transaction within 15 days following the first sale. It is notable that the failure to file or to timely file this Notice does not mean you lose the exemption.

However, when originally introduced SB 978 would have changed the law such that the failure to timely file the notice *would have* resulted in a complete loss of the exemption (arguably allowing an investor to later demand that the company rescind the investment and return their money simply because a notice was missed or was filed after the first sale's filing deadline!).

Luckily, SB 978 was recently amended to remove this harsh penalty for failure to timely file the notice, and the bill no longer provides that the exemption is lost if the notice is not filed.

As far as the impact SB 978 would have on any federal securities exemptions, if the offering is pursuant to Rule 506 it should be unaffected by SB 978 because the law provides that federal law, not state law controls those offerings (there is still a filing to be made in California however). Transactions relying on Rule 504, 505 or 4(2) would potentially still be affected by SB 978.

We will continue to monitor SB 978 and hope that they do not decide to reinsert some of these severe penalties.

Please contact Brandon Smith at bds@sfcounsel.com for more information.

- Written by Brandon Smith

Raising Money for your Startup Through Crowdfunding

An increasingly popular way of funding your startup is the concept of "crowdfunding," which involves getting small donations from many different individuals (for example $1,000 from 100 individuals rather than $25,000 from 4 individuals). In the past, this method of fundraising was not specifically exempt under the Securities Act. However, it was officially recognized and exempted from the

registration requirements under the Securities Act by the SEC as a result of President Obama signing into law the Jumpstart Our Business Startups Act ("JOBS Act") on April 5, 2012.

To qualify, you can raise no more than $1,000,000 in a 12-month period. There are also limits on how much you can raise from any one investor, depending upon the financial position of that investor. Specifically, the aggregate securities sold to any investor in the 12-month period shall not exceed (a) the greater of $2,000 or 5 percent of the investor's annual income or net worth, if either the annual income or net worth of such investor is *less* than $100,000; and (b) 10 percent of an investor's annual income or net worth, not to exceed a maximum of $100,000, if either the annual income or net worth of such investor is *equal to or greater* than $100,000.

Additionally, the transaction must both (a) be done through a broker or funding portal intermediary that is in compliance with the requirements of Section 4(A)(a) of the Securities Act, and (b) the issuance must comply with new requirements in Section 4(A)(b) of the Securities Act. As with other investments in private companies, the securities will be restricted securities, meaning that they cannot be sold or transferred without complying with the time frames and requirements in the Securities Act.

In sum, if you cannot raise money through traditional exemptions under the Securities Act or through traditional investors, you can now look to raise money through crowdfunding, provided you can meet the criteria set forth in the Securities Act.

Please contact Brandon Smith at bds@sfcounsel.com for more information.

- Written by Brandon Smith

Areas of Practice

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

©2007-2012 Scherer Smith & Kenny LLP. All Rights Reserved.
Disclaimer/Privacy Statement
For more information: www.sfcounsel.com