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 Associate Joins Scherer Smith & Kenny LLP

We are pleased to announce that Ryan Webster Stahl has joined our firm as a new associate. Ryan is a graduate of UC Davis School of Law and was formerly a Law Clerk for the Honorable Richard M. Clark, U.S. Department of Labor, Office of Administrative Law Judges. He is a valuable addition to our firm and will be working closely with Denis Kenny on litigation and employment matters. Ryan is an avid cyclist as well. We hope that you have an opportunity to meet Ryan soon and we look forward to his becoming a valuable member of our team.

Employer Alert: Timekeeping iPhone App

The U.S. Department of Labor recently introduced the "Timesheet App," an iPhone app which is free and available in English and Spanish. See http://itunes.apple.com/us/app/dol-timesheet/id433638193?mt=8

The app lets employees track their own hours and determine gross wages due, including overtime. The app also allows employees to add comments about their work and produce a summary of hours worked per day/week/month. The summary is formatted to be readily emailed as an attachment (in my opinion, for ease of transmittal to prospective plaintiff's attorneys considering lawsuits and/or state and federal auditing agencies cracking down on payroll fraud).

The impetus for this app is the increasingly prevalent practice of "timesheet fraud" by employers who intentionally exclude overtime hours from their employees' timesheets (often times by having a written policy confirming the documentation and payment of overtime but verbally instructing their employees not to include anything more than 8 hours per day and 40 hours per week on their submitted timesheets). In overtime pay disputes, employees' own records on the app can provide powerful evidence in these types of cases where employers do not keep accurate records.

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

- Written by Denis Kenny

The Folly Of Ignoring Your Brand

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Partner Notes

Brandon Smith

Welcome to the fall edition of *Perspectives*. In typical San Francisco fashion, warm summer weather is finally here as we welcome fall. I was lucky enough to attend the Cal vs. USC football game a few weeks ago, and we were actually able to sit outside at

We all know that valuable lessons can be learned from watching the actions of others, but it is often the *inaction* of others that can be just as instructive. Twitter is proving this to be the case with their fight to register "tweet" with the United States Patent and Trademark Office (USPTO). While nearly everyone would likely associate the word "tweet" with Twitter, Inc., its failure to file an application back in the early days of the company is coming back to haunt them and may ultimately result either in multiple parties having the right to use the word "tweet" or the complete loss of ownership and control over that name if it becomes generic.

Back in April, 2007, Twitter filed its trademark application for "Twitter" but unfortunately did not file its application for "tweet" until April, 2009, nearly two years later. Had they done so, it would have saved them thousands, probably tens of thousands, of dollars in legal fees. Instead, the USPTO suspended their application because of applications for "cotweet" (now owned by Twitter), "tweetphoto," and "Tweetmarks" (interestingly, all three applications were filed in March, 2009, one month before Twitter filed its application for "tweet"…). Twitter filed again in August, 2010, and the USPTO once again rejected the application, this time relying on the registered mark "Let Your Ad Meet Tweets," which was registered in October, 2009, and is owned by Twittad. Twitter has now filed a lawsuit against Twittad in an attempt to get its own trademark application registered. Presumably they are relying on common law rights as the basis of their claim, which can work but are also difficult to prove.

The speculation as to why Twitter would have waited continues to circulate, but likely reasons include (a) costs (even though a trademark application is relatively inexpensive startups often try to conserve money by cutting applications), (b) underestimating how catchy the word "tweet" would become, and (c) actually wanting third parties to use the term to generate hype in the industry around Twitter and the service. This last reason is risky, in that Twitter cannot afford to have the term used too generally on penalty of its becoming a generic description for sending that type of message. This would result in a near total loss of protection over the mark.

All is not lost, though. A company that finds itself in Twitter's position has several options other than expensive and time consuming litigation. These include buying the company that registered and first began using the mark, such as what Twitter did with "Tweetdeck," which Twitter bought for $40 million in 2011. A company can also oppose a conflicting trademark application that was filed first but that may be trumped by the company's mark. This is what Twitter did with "25 Tweets," "Tweetmarks," "Tweetiator," and other applications. Finally, a company can simply send a cease and desist letter to the other company demanding that it stop using the mark and abandon any filed application. This is often successful and much less costly than the other options.

We don't know how the lawsuit against Twittad will end up, but it is clear that Twitter is trying to send a message to potential infringers about using the word "tweet." Regardless of the outcome, Twitter is establishing once again Ben Franklin's quote of "*An ounce of prevention is worth a pound of cure*."

For more information about how you can protect your brand through trademarks or for other information about intellectual property please contact Brandon Smith at bds@sfcounsel.com or Heather Sapp at hgs@sfcounsel.com.

- Written by Brandon Smith

Statute Virtually Eliminates New CID Rental Restrictions

We are writing to bring your attention to an important and time-sensitive new California law that will significantly restrict the ability of common interest developments (which include condominium projects, stock cooperatives, planned developments and community apartment projects) ("Associations") to enforce rental restriction provisions in their CC&Rs.

AT&T Park for the entire game without jackets (lucky because of the weather, not the score, unless you are a USC fan). I hope that you had a great summer and found some time to spend with your families and friends. Everyone at the firm is now back from their various vacations and ready to work before the Holidays begin. It seems our clients have followed a similar approach, since we have been getting a much higher number of calls recently for new projects. I don't know how much of this is the economy continuing to pick up steam, or whether it is just due to the end of summer break and our clients' attention turning to business once more.

This month we welcome a new attorney to our firm, Ryan Stahl, who is joining us after clerking for the past two years for the Honorable Richard M. Clark, U.S. Department of Labor. Ryan will be working closely with Denis Kenny in handling employment and litigation matters and is a valuable addition to the firm. In addition to being a great lawyer, Ryan is an avid cyclist, having recently completed a century ride in Davis, California, where he was joined by Bill Scherer, who also completed the ride. We are looking forward to having Ryan as a part of our team.

Personally, I've been receiving a number of projects recently in which clients are buying or selling businesses or raising

The recently chaptered California S.B. 150 amends the Davis-Stirling Common Interest Development Act – the law that governs California Associations – to limit the enforceability of CC&R rental restriction provisions that are recorded on or after January 1, 2012 .

Specifically, the new law invalidates the enforcement of any provision in an Association's governing document that prohibits or restricts the rental or leasing of all or any part of an owner's separate interest in a CID to a renter, lessee, or tenant unless the provision in question was effective prior to the date the owner acquired title to his or her separate interest. This law takes effect January 1, 2012.

Thus, if your Association's governing documents either do not currently have any rental restrictions or they are weak, and it wants to enact or strengthen them, you must amend your CC&Rs to add such a restriction before January 1, 2012 . Any provision enacted after such date that prohibits owners from renting their units may well not be enforceable against current unit owners in your project. Although the statute's language leaves room to argue that certain rental restrictions (as opposed to outright prohibitions) may remain available to Associations, S.B. 150's legislative history strongly indicates that the statute is meant to apply to any prohibition, whether partial or total.

If your Association is considering the adoption of major or minor rental restrictions, we recommend that that the board immediately begin the process of amending the CC&Rs to ensure that any amendment takes effect not later than December 31, 2011.

Scherer Smith & Kenny LLP is available to assist Associations in the preparation of leasing restriction amendments, preparation of the secret ballot and voting instructions for such amendments, and the recording of these restrictions, once approved.

If you are interested in pursuing such an amendment, please contact Bill Scherer at wms@sfcounsel.com or Heather Sapp at hgs@sfcounsel.com for more information. And, as always, please don't hesitate to contact us if we can assist you in any related matters.

- Written by Bill Scherer

The IRS Worker Misclassification Settlement Program and California's S.B. 459: Employers Beware!

The IRS recently launched Voluntary Compliance Settlement Program ("VCSP" or the "program") purports to offer employers relief for voluntarily reclassifying their workers as employees.

We see many potential problems with this program. A few of the more obvious problems are discussed below along with a brief "refresher" on the pitfalls of worker misclassification, including the impact of S.B. 459, the recently enacted California worker misclassification legislation dubbed by some as the "job killer" law. Incidentally, I recently attended a seminar conducted by IRS representatives responsible for enforcing employment tax laws. The audience (which primarily included HR executives and employment lawyers) posed many questions concerning the interpretation and possible future impact of the VCSP. Unfortunately, none of the questions and concerns was answered in any coherent manner by the IRS representatives. Consequently, we view this employer warning as very real.

Employer Payroll Tax Withholding and Contribution Obligations

Where a hiring party treats a worker as an independent contractor, the hiring party withholds no taxes from amounts paid to the worker. For each calendar year, the hiring party must prepare a Form 1099 reporting the gross amount paid to the worker during the year, and timely send it to the IRS and a copy to the worker.

Where a hiring party treats a worker as an employee, however, the hiring party as the employer must withhold income tax from the employee's wages, Social Security tax at 6.2% on the first $106,800 of gross wages earned

money from investors. In contrast to what we saw happening just a few years ago, these transactions are generally not distressed sales or desperate attempts to raise working capital, which I take as a great sign of economic recovery. I also continue to have a steady stream of trademark matters and new business matters.

We hope that the rest of 2011 is a good one for your business and your families. Happy Holidays!

during a calendar year, and Medicare tax at 1.45% of gross wages without limit. The employer must deposit the withheld income tax, Social Security tax, and Medicare tax, as well as a matching amount of Social Security tax and Medicare tax, with the IRS. For each calendar year, the employer must prepare and issue to the employee and file with the IRS a Form W-2 reporting the employee's gross pay, tax withholdings, and net pay.

In short, employers pay less to workers who are classified as independent contractors rather than employees. This works well when workers are properly characterized, but severe problems arise when they are misclassified.

Consequences of Worker Misclassification

When an employer misclassifies a worker as an independent contractor, the collateral damages and legal ramifications can be enormous, including back taxes, plus interest, and a fine of up to 35% of the total compensation and 100% of the taxes that were not withheld. Misclassification exposes the employer to additional employment-related liability and damages, including possible wage and hour (i.e. unpaid overtime, missed meal and rest periods and the like), workers' compensation, and unemployment insurance claims. And, the impetus for this proverbial "parade of horribles" can start with something as simple as a single claim for unemployment insurance benefits filed by a disgruntled former worker (who, more times than not, willingly signed a contract to provide services on an independent contractor basis).

The legal ramifications of misclassification are only getting worse as state and federal agencies grapple with ways to bring funds into their depleted coffers. For example, California recently passed S.B. 459 (codified at California Labor Code section 226.8 and referenced in other related statutes) which prohibits and punishes the "willful misclassification" of employees as independent contractors (and/or unlawful deductions from employee's pay under California Labor Code sections 221 and 224) and imposes stiff civil penalties for each violation ($5,000 to $15,000 *per violation*) and even higher penalties ($10,000 to $25,000 *per violation*) if a "pattern" of violations is found. And, make no mistake, the legislation is intended to be broadly construed against business as it would appear to include instances of misclassification even if the putative employer truly believed they were legally classifying the independent contractors but were, in fact, wrong (*i.e.* "willful" includes situations where the employer "should have known" about the misclassification).

The Blurry Line between Employee and Independent Contractor

There is nothing close to a bright-line rule for worker misclassification. A variety of "tests" used by different state and federal agencies range from 10 to 20 factors which must be weighed and balanced on a case-by-case basis. In sum, a worker is an employee if the person for whom he/she performs the services has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is accomplished." Factors weighed in determining whether a worker is an employee include whether the worker undergoes training sponsored or specified by the hiring party; whether the services are performed based on the instructions of the hiring party, during hours set by the hiring party, with tools provided by the hiring party, on the premises/facilities of the hiring party; whether the worker makes oral or written reports to the hiring party; whether the worker is paid by the hour, week, or month; whether the worker makes an investment in the subject project for which he/she is being retained; whether the worker realizes a profit or loss; whether the worker hires, supervises, and discharges assistants; and whether the worker works for more than one individual/entity at a time. No one factor is determinative.

Consequently, court and agency classification decisions widely vary. Oftentimes, virtually the same facts and analysis that lead one court or agency to make a finding of proper independent contractor classification in one instance results in the opposite conclusion in another instance. Given the gravity of uncertainty and exposure which companies face concerning misclassification, the safest rule of thumb to follow is: when in doubt, treat the worker as an employee. The downside risks of misclassification are simply too great to come close to outweighing the potential benefits of independent contractor classification.

Problems with the VCSP

Under the VCSP, if an employer voluntarily comes forward and reports that they have been misclassifying their employees as independent contractors the IRS would require that they only pay approximately 10% of the back taxes. The IRS also promises no audits and no penalties on unpaid back taxes.

So, the potential cost-savings in misclassification-related back taxes and penalties are significant However, there are many downside risks including:

- The employer must admit, under penalty of perjury, that it has been misclassifying workers and provide details (the identity of the workers, amount of compensation paid, period of time of misclassification, etc.). And, since the IRS has "information-sharing" agreements with 38 states (including California), the VCSP application, in itself, (regardless of whether it is approved by the IRS) could be just the start of the employer's problems extending into the various states where they do business. For example, under California 's S.B. 459, the program application could serve as an admission of misclassification liability for which an employer would face stiff civil penalties for each violation and even higher penalties if a "pattern" of violations is found. Moreover, since the IRS has no control in courts as far as labor laws are concerned, the companies that do come forward will be opening themselves up for lawsuits (including class actions) for overtime back pay and other possible employment claims.

- An employer subject to any type of a tax audit is not eligible for the program (and "audit" is not a defined term so it is unclear whether this might include something like an unemployment insurance claim from a former worker, for example).

- The IRS decision to "settle" rests in its sole discretion; in other words, even if the employer meets all other requirements, the IRS can simply say, no.

- The "settlement" extends the statute of limitations on future tax years/filings from 3 to 6 years (which means that employers may be targeted by the IRS for future audits).

I could go on and on. But, suffice it to say, I would have a hard time recommending the VCSP to any of my clients without some compelling answers to many of the questions and concerns listed above. Nonetheless, given the clear state and federal interest in weeding out independent contractor misclassification and bringing in funds to much-depleted coffers, this is a critical time for businesses to take a careful look at their independent contractors to confirm that they are properly classified. Businesses are, thus, strongly advised to seek legal counsel to assist in understanding the potential implications of your current practices.

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

- Written by Denis Kenny

Areas of Practice

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

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