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Welcome to Insights,

a quarterly newsletter from Patton Martin & Sullivan designed to keep you up-to-date on legal issues that may impact your business.

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Crowdfund Act Brings Big Changes to Start-Up Investing

By Ralph Kokka

A new investment law could revolutionize capital fundraising or become a new vehicle for fraud. The jury is still out. A few months ago, President Obama signed the JOBS Act into law. One of the key sections of the JOBS Act is the CROWDFUND Act, which will make substantial changes to how private businesses can raise money. Under previous SEC rules, a private company was basically limited to seeking investments from accredited investors (i.e., investors with a net worth of $1,000,0000 or annual income in excess of $200,000 for the past two years). These rules limited companies to seeking money from wealthy investors or funds such as angel investors or venture funds.

The CROWDFUND Act democratizes the fund raising process by enabling a company to seek investments from just about anyone, subject to certain limitations. Under the CROWDFUND Act, companies can raise up to $1,000,000 during any 12 month period from crowdfunded investors. Investors who make less than $100,000 per year can invest up to the greater of 5% of annual income or $2,000 in a single company. Investors who make more than $100,000 can invest up to 10% of their annual income or net worth in a company. Crowdfunded investments are required to be conducted through an intermediary, such as the current websites, Launcht and Kickstarter. Presumably, (Cont. page 2)

Rural Landowners Look for Cooperation from Department of Fish and Game

By Martin Inderbitzen

Rural landowners have reason to be encouraged by the recent actions of the California Department of Fish and Game (DFG) and the Alameda County Resource Conservation District (ACRCD). The two are working with each other, rather than against each other, to forge a program that will facilitate agricultural activities by helping landowners move through the permitting process more efficiently.

Too often the DFG, through its enforcement efforts of the California Endangered Species Act (CESA), becomes an impediment to the ongoing agricultural activities of the ACRCD's constituent farmers and ranchers. As a result, either agriculture suffers or protection of threatened and endangered species suffers.

But now, ACRCD and DFG are working together to advocate (Cont. page 2)

(Crowdfund, cont. from page 1)
others will join the fray. Intermediaries must register with the SEC as either a broker or funding portal. The regulations for funding portals is lighter because funding portals agree not to solicit purchases, offer investment advice or handle investor funds. Companies are required to disclose certain basic information to crowdfunded investors, including CPA reviewed financial statements for offerings between $100,000 and $500,000 and audited financials for offerings between $500,000 and $1,000,000.

Presently, the CROWDFUND Act is being reviewed by the SEC as part of its rulemaking process, which is expected to be completed by the end of the year. The CROWDFUND Act's lower income thresholds for investors and its streamlined disclosure requirements could revolutionize the capital raising process for small companies. At the same time, however, these same features could make it easier for scammers and frauds to prey upon the unsophisticated investor. Whether the CROWDFUND Act is an investment boon or bane remains to be seen.

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(Rural, cont. from page 1)
a Voluntary Local Program (VLP) for farmers and ranchers engaged in agricultural activities in Alameda County.

Recognizing the ranchers and farmers are good stewards of the land, the purpose of the VLP is to create a process whereby landowners who wish to restore and enhance the natural resources on their property are provided with technical assistance and also provided with protection from the incidental "take" of endangered, threatened or candidate species.

The ACRCD is the lead agency in an Initial Study and Mitigated Negative Declaration issued July 2012 requesting authorization of the VLP and take authorization pursuant to Section 2086 of the California Fish and Game Code. If approved, the program will cover public and private lands managed as agricultural lands within the County. Landowners will still have to obtain any other applicable permits such as, Section 1600 permits and compliance with Federal Endangered Species Act regulations. There is still a long way to go before the VLP is implemented. Comments on the IS/MND closed on August 17, 2012. However, it is definitely a step in the right direction for DFG to recognize that landowners know their land best and their efforts at restoration and enhancement for agricultural purposes may also serve as enhancements for protection of endangered species.

For more information, visit the Alameda County Conservation Partnership.

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Court Confirms Real Estate Brokers Are Not Personally Liable for Acts of Corporation

By Randy Sullivan

California Real Estate Brokers can breathe a little easier now that the courts have reaffirmed that if they have properly incorporated, ordinarily they will not be personally liable for the acts committed by corporate employees or agents.

Most of us understand that by forming a corporation the directors, officers, and managers are not personally liable for the acts committed by the employees or agents. Instead, it is the corporation that is liable.[1]

Similarly, most real estate brokers selling real estate or originating loans have understood that they are shielded from personal liability by incorporating a business and having the license held by the corporation while remaining as the broker of record. Likewise, most California defense attorneys have shared this opinion, and the leading California Real Property treatise also shared this viewpoint.

However, the issue of the scope of a designated real estate broker's liability for the actions of the corporation had been called into question by a Ninth Circuit opinion, *Holley v. Crank*, (9th Cir. 2005) 400 F.3d 667. In the opinion of this author, *Holley* case the Ninth Circuit aggressively read the legislative history of Business and Professions Code, section 10159.2 in an attempt to reach an equitable result.

The specific portion of the pertinent statute at issue was:

The officer designated by a corporate broker licensee pursuant to Section 10211 shall be responsible for the supervision and control of the activities conducted on behalf of the corporation by its officers and employees as necessary to secure full compliance with the provisions of this division, including the supervision of salespersons licensed to the corporation in performance of acts for which a real estate license is required.

Ultimately the Ninth Circuit held that the purpose of the statute was to "insure licensed supervision of real estate corporation activity by holding designated officers personally responsible for that supervision." Id. at 672. As stated above, the Ninth Circuit appears to have done this in order to arrive at an equitable result. Notably, the underlying claim involved a borrower having been racially discriminated against in violation of the Fair Housing Act. In addition to the discriminatory acts, the case allegedly involved a situation where the qualifying broker turned over all operations of the brokerage company to a non-licensed person.

While these were significant distinguishing facts, in many cases Plaintiffs had relied on the case to support claims against the qualified broker. The potential confusion caused by *Holley* now has been largely resolved in the California opinion in *Sandler v. Sanchez* (2012) 206 Cal.App.4th 1431.

The Sandler decision

The Court in *Sandler* first addressed the interpretation of Bus. & Prof. Code S. 10159.2. The Court held that the duties do not extend to third parties. Id. at 1438-1440. Rather, the qualified broker owes the duty to (Cont. page 4)

[1] This discussion excludes claims where a party is attempting to pierce the corporate veil by way of alter ego allegations.

(Court, cont. from page 3)
the corporation and that it is the Department of Real Estate that can hold the qualified broker accountable. The Court decided that the intent of the statute was to make express that the qualified broker did have a duty to supervise. The Court further found that the purpose of the statute was to create a regulatory sanction, but not a duty to third parties.

Second, the Court found it persuasive that in other similar statutory schemes the qualifying licensed person does not have a duty to third parties. The Court cited the statutory scheme for licensed construction contractors. Id. 1441. The Court also noted that the language is substantially similar and yet there is no duty to third parties by the company's responsible managing licensee. Id.

Third, the Court directly addressed *Holley*. The Court honed in on one critical fact in that Ninth Circuit case, which was that the qualified broker had sold the business to the person that allegedly conducted the racial discrimination, and that he would remain the designated officer/broker until the bad actor received his broker's license. Id. at 1444. The Court ruled that there was not an implied delegation of responsibility in *Holley*, but instead an actual agreement that the bad actor "would assume the responsibilities imposed on the designed officer/broker by section 101059.2." Id. at 1445.

In closing, the Court stated that it will not express an opinion on whether it agreed with the Ninth Circuit about whether "a designated officer and real estate salesperson can ever create principal-agent relationship." Id. The statement alone casts doubt on the decision itself in *Holley*. More importantly, within the context of that statement, the Court ruled that mere inaction would not suffice to create personal liability.

Based on these rulings, the Court held that the Plaintiff's underlying claim failed where the allegation was that the designated broker did not supervise the salesperson managing the transaction, and that if he had then he would have learned about material misrepresentations and disclosed them to Plaintiff or cancelled the deal. Plaintiff's claims were proper against the corporation but not the qualified broker.

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Off-the-Cuff Misappropriation Claim Never a Good Idea

By Kevin Martin

Employers beware. Suing departing employees for trade secret misappropriation without real evidence can easily backfire.

In a classic win for employees, the California Court of Appeal, Fourth Appellate District filed a decision July 11, 2012 in SASCO v. ROSENDIN ELECTRIC, INC. , 12 C.D.O.S. 7883, confirming a postjudgment order from the Orange County Superior Court of California awarding several former employees of electrical contractor SASCO nearly $500,000 in attorney's fees and costs on the basis that plaintiff brought its misappropriation of trade secrets claim in bad faith.

SASCO and defendant Rosendin are licensed electrical contractors doing business in the State of California. Individual defendants Fitzsimmons, Thompson, and Woodworth worked for SASCO in senior management positions until the fall of 2006. Individual defendants each signed nondisclosure agreements with SASCO. Each of the individual defendants resigned from SASCO and joined Rosendin on different dates in October and November 2006. SASCO subsequently sued defendants after it lost out to Rosendin on a project which at least one of the defendants had been working on while with SASCO, known as the Verizon Tustin Project. SASCO alleged five causes of action, including misappropriation of trade secrets, along with the usual other claims we see in these types of cases intentional interference with prospective economic advantage, unfair business practices, breach of contract and breach of implied covenant of good faith and fair dealing. In discovery, SASCO identified the trade secret at issue as "a proprietary computer program which creates monthly construction project reports" and is used to estimate costs and manage projects. On May 1, 2009, defendants filed a motion for summary judgment. Although SASCO obtained continuances of the summary judgment hearing to conduct additional discovery, it ultimately voluntarily dismissed the action without having filed any opposition.

Following the dismissal, Defendants sought award of its attorney's fees and costs pursuant to California Civil Code section 3426.4 which provides that "if a claim of misappropriation is made in bad faith… the court may award reasonable attorney's fees and costs to the prevailing party." Courts have concluded that "bad faith" as used in section 3426.4 consists of both "objective speciousness of the plaintiff's claim… and [] subjective bad faith in bringing or maintaining the claim." (Gemini Aluminum Corp. v. California Custom Shapes, Inc. (2002) 95 Cal.App.4th 1249; see also FLIR Systems, Inc. v. Parrish (2009) 174 Cal.App.4th 1270, 1275; and CRST Van Expedited, Inc. v. Werner Enterprises (9th Cir. 2007) 479 F.3d 1099, 1111.) Because section 3426.4 authorizes the trial court to award fees as a deterrent to specious trade secret claims, the Court has broad discretion under this statute in making its decision.

In affirming the trial court's award, the appellate court was particularly critical of SASCO's speculation that the individual employees "must have taken trade secrets" based on their decision to change employers to Rosendin, and Rosendin's success in obtaining the Verizon Tustin contract. This sentiment echoes California's employee favorable climate. Citing King v. Pacific (Cont. page 6)

(Off-the-Cuff, cont. from page 5)

Vitamin Corp. (1967) 256 Cal.App.2d 841, 85, the Court noted that mere intent to "take aware some of plaintiff's business did not prove their actions to be wrongful." As suggested in the King case, "there is virtue in fair competition in business even though a competitor is hurt." Id. at ___. The Court also rejected plaintiff's argument that at the time it filed, it appeared that "some evidence" would be obtained in discovery supporting a misappropriation claim. "Bad faith" refers solely to a party's subjective mental state, and under 3426.4, this means the action was commenced or continued for an improper purpose, such as harassment, delay or to thwart competition. Ultimately, the trial court found and the appellate court confirmed that there was no evidence in the record supporting the claim of misappropriation AND that SASCO brought and maintained the claim for an improper purpose. These together amount to bad faith under section 3426.4 and justified the award.

Employers need to carefully consider including trade secret misappropriation claims in any litigation. Making such a claim as a means to stymie competition or hinder former employees from taking positions with competitors can lead to disastrous results as shown above. Conducting even a minimal amount of investigation before filing suit and making a reasoned decision based on the evidence from that investigation can be the difference.

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