Los Angeles lawyers Paul Sczudlo and Megan Lisa Jones analyze provisions of the Tax Cuts and Jobs Act that relate to foreign income and investments.
Please join us
36th Annual Red Mass
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Nearly a century ago, playwright George Bernard Shaw said, “Democracy is a device that ensures we shall be governed no better than we deserve.” From the look of things lately, and, in particular, the reaction to the announcement by President Trump of his choice to replace retiring Justice Anthony Kennedy, I am afraid Shaw was not far off in his observation.

Almost from the minute the retirement was announced, the hand-wringing began. Who will the president appoint? Will the president stack the court in favor of conservatives? If the president is successful in stacking the court, what will happen to Roe v. Wade and other long-standing laws and legal opinions upholding rights many hold dear? When the president announced his candidate, D.C. Circuit Court of Appeals Judge Brett Kavanaugh, Republicans endorsed the choice immediately without any real analysis of how Judge Kavanaugh’s prior opinions and interpretation of the Constitution may impact long-established rights that many consider essential to our constitutional democracy. Democrats, on the other hand, immediately went to Twitter, pledging they would block Judge Kavanaugh’s confirmation instead of giving the candidate the benefit of the doubt until questioning could begin in the confirmation process.

While there is no doubt that concerns regarding the possible scaling back of rights and matters of equal protection by a conservative-leaning Supreme Court deserve serious consideration, ultimately, we should place more faith in our American system of jurisprudence and the separation of powers provided in our Constitution. Our system is not perfect, but compared with most other forms of government, it is one of the best. And more often than not, it works as it should.

The heightened emotions that many have been feeling over the past two years is understandable but not helpful. It obfuscates the path to resolution of most disputes: the courts and our legislative process. Patience is required as justice can move slowly. But, in the end, it is our unparalleled system of laws and checks and balances that will be our salvation.

In the meantime, we must encourage open and courteous dialogue, exercise respect for one another, avoid hyper-partisanship and, much as it is in our courts of law, agree to disagree and then compromise when individual points of view diverge—a necessary step to reconciliation.

Given the stakes, it will not be easy. But the alternative is not an option. Right now, it seems that everyone—including our elected representatives—has forgotten that there is a way through these uncertain times. We have faced far more daunting crises during our history, and we will no doubt continue to face such adversities. The hope is that we not only grow as a nation but also as individuals. The goal is to strengthen our resolve as a nation of laws and to continue to strive for justice, fairness, and the rights of all those dwelling within our borders.

If we cannot embrace these ideals and let our system work the way it was intended, we will indeed be governed by a government we deserve—and it won’t be pretty.

Rena E. Kreitenberg is the 2018-19 chair of the Los Angeles Lawyer Editorial Board. She is a partner in the Los Angeles law firm of Mesisca Riley & Kreitenberg LLP where her practice focuses on civil litigation and appeals, emphasizing real estate, negligence, and employment actions.
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Membership Is and Always Will Be Job One

ONE OF THE BEST PARTS of my job is the opportunity to meet attorneys throughout the county and to share information about our innovative new programs and projects. Invariably, the response has been positive and the energy to re-engage renewed as we collaboratively move forward together.

We all know the challenges LACBA and almost all other bar associations are facing relative to membership. In light of that, it is easy to forget the good and focus instead on the not so good. I want to focus on the good that we’ve been working on the past few months and why your LACBA membership matters.

In February, LACBA began a telemarketing campaign aimed at non-renewing members from 2017. The effort has generated more than in $420,000 and over 900 renewals. Member Services Director Phyllis Hauser and her team deserve the credit for this success and it illustrates the power of everyone—staff, board, committee and section leaders, barristers and senior lawyers asking and asking again.

The “Bring a Guest” campaign launched earlier this year has been enhanced with new incentives for both guest and host. A member treats a non-member guest to a complimentary section program (three hours or less) for free as well. The member who brings that guest will receive a value) for a year. The member who brings that guest will receive a

A guest who signs up for LACBA membership at the CLE program (three hours or less) to experience the best in legal education. A guest who signs up for LACBA membership at the event will receive one complimentary section membership (a $50 value) for a year. The member who brings that guest will receive a section program (three hours or less) for free as well.

Four specialty bar associations have expressed interest in becoming affiliate bar partners.

The empowerment and support of our professional staff to be creative and partner with sections and committees has resulted in our 10-episode Admitted podcast series directed towards law students and newer lawyers. The first three episodes received more than 600 downloads with new episodes every other week. Marketing and events staff members Lynz Floren and Melissa Algaze deserve credit and kudos for this outstanding resource.

The LACBA mobile app with integration to the member database will debut next year. Members will be able to create their own mobile member experience through the app: pay dues, register for events, post photos, and interact with members in a new and exciting way.

LACBA’s e-filing preferred provider benefit is now available thanks to Trustee Eve Lopez, President-Elect Ron Brot, and LACBA General Counsel Steve Stathatos.

Building on the successful LACBA program, “How to Talk to Someone in Crisis,” we are setting up a LACBA hotline for any attorney, member or not, in crisis. The service will also be a resource for family members, friends, and associates who see warning signs in those they care about and need a place to turn for advice and support.

A member discount program at Brooks Brothers is in place and another is in the works with Audi.

Anniversary dues billing and easier payment options will even out cash flow challenges and eliminate the pro-rated dues mess for new members.

A retired member category and reinvigorated e-membership for attorneys outside of Los Angeles and Orange County has been established.

A campaign is underway to remind members and affiliated bars to take advantage of the fully equipped members lounge at LACBA headquarters, a great place to work or relax between meetings downtown.

LACBA’s presence and engagement on social media, through Facebook, Instagram, Twitter, LinkedIn, and other appropriate channels has been significantly enhanced.

This year, we have embraced events that are fun, stand-alone social gatherings such as the sold-out private screening of “RBG,” the documentary about U.S. Supreme Court Justice Ruth Bader Ginsburg, at the Westside Pavilion in May. Also in May, Los Angeles Lawyer celebrated its annual entertainment law issue with a launch party and MCLE panel in the Century City offices of event co-host Greenberg Traurig. Cosponsored by the Labor and Employment Law Section, the cocktails-and-CLE event was standing room only.

The launch of LACBA international travel, with Cuba as our first trip, is scheduled for early December 2018 followed by Morelia, Michoacan Mexico in 2019, the seventy-fifth commemoration of the Nuremberg trials in 2020, and the 2021 LACBA Oxford Experience. These programs generate non-dues revenue in addition to integrating our professional lives with our personal passions.

We have renewed and rededicated our commitment to pro bono opportunities and our four projects—AIDS Legal Services, Veterans Legal Services, Domestic Violence Legal Services, and Immigration Legal Assistance—that speak to younger lawyers and law students looking to make a difference through personal action and outreach. These projects are reflective of a modern and dynamic bar and set LACBA apart as the only bar in Southern California dedicated to serving our most vulnerable through a committed and dedicated membership focused on social responsibility and service.

We are 20,000 members with 26 sections and 15 committees successfully sponsoring and supporting more than 250 programs a year. We are the voice of the legal community in Los Angeles for the law student, the new lawyer, and the attorney who occasionally needs to be reminded that what you do matters and, that you are not alone. We are as much professional as we are personal—we are a family that looks after one another and advocates for those who cannot. We are LACBA, 140 years young, and we’re just getting started.

Stan Bissey is executive director of the Los Angeles County Bar Association.
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Who Really Knows What LACBA Counsel for Justice Does?

WHEN I DECIDED to become more involved with the leadership of the Los Angeles County Bar Association, I had doubts about whether Counsel for Justice (CFJ) should (or even could) continue. I now know that the work CFJ does is vital to the people of Los Angeles County and the members of LACBA.

People unjustifiably attacked CFJ in the past. They asked whether CFJ is necessary. After serious consideration and research, I can confidently say that it is necessary. There is far too great a need throughout the county for us to sit on our hands and leave our fellow Angelinos to suffer. But how many LACBA members even know what CFJ does? As I became more involved with this organization, I kept asking hard questions about CFJ volunteers, CFJ programs, and what kind of results the project was getting on behalf of the underserved.

CFJ is charged with raising money and awareness for LACBA’s four primary nonprofit activities. Each is independently important and impacts the most vulnerable members of our community who have the least access to justice:

• The Domestic Violence Legal Services Project provides free legal counseling through volunteers who help victims of domestic violence seeking redress in the courts, including temporary restraining orders and protection from further abuse.
• The Immigration Legal Assistance Project provides volunteer lawyers to help residents of the County of Los Angeles with immigration problems while following immigration laws that are ever changing and under scrutiny on a national basis.
• The Veterans Legal Services Project provides free legal counseling for veterans experiencing a myriad of legal woes.
• The AIDS Legal Services Project provides legal counseling for county residents who are living with HIV and AIDS.

Anyone who pays attention to the news, walks through our streets, or is concerned about all our citizens knows this is a time when we need true warriors for justice. Our homelessness crisis borders on catastrophe, with tens of thousands living on the streets throughout Los Angeles County—many of whom are veterans who have served our country selflessly. The immigration crisis is not just hitting home, it is literally ruining families who have been in this country for decades. The people of Los Angeles County need us now more than ever, and we simply cannot abandon them.

However, I have also found that CFJ suffers from potentially bad timing. Even with amazing volunteers, these projects cost money at a time when resources are short. The volunteers for these projects have fought hard to raise awareness and additional funding to help offset the operating costs, but we all can do more to help these projects flourish and be effective.

So, going forward, what do we need to do? First, I believe we need to change the name. “Counsel for Justice” is certainly a fine name that was conceived by hard-working volunteers of this organization. It is not, however, descriptive of the good work done on a day-to-day basis. The name needs to be returned to the Los Angeles County Bar Foundation or something similar that invokes an immediate recognition that the organization is charitable in nature, providing good services and good work to the people of Los Angeles County. This also will help to raise money.

Second, we need to develop an outreach program focusing on corporations, companies, and other business entities that work and prosper in the County of Los Angeles as a way to give back to its citizens through LACBA’s volunteer activities. I have no doubt that many of these activities speak to businesses that operate inside the city and county of Los Angeles.

Next, we need to meet with the major sports teams in Los Angeles—baseball, football, basketball, hockey, and soccer. Los Angeles has no fewer than eight professional sports teams, as well as two powerhouse college programs. These teams would adequately demonstrate their dedication to the domestic violence problem in our country by supporting and contributing to LACBA’s Domestic Violence Legal Services Project.

In terms of funding challenges, we must be better. This includes developing a robust fund-raising program to reach out to many of the well-heeled Los Angeles County residents. I believe we also need to retain professional grant writing assistance. Many foundations and other organizations may not be fully aware of the good work of CFJ and its staff and volunteers. We need to show them how we can put their dollars to work improving our community. We have to continue to train and promote the volunteer fund-raising members of CFJ’s board of directors. Led this year by President Brian Condon, these lawyers donate their time. We can do more to help them do their job. Plus, we absolutely need to train the members of LACBA’s Board of Trustees, CFJ, the Barristers, and all section leaders to work as ambassadors to fund-raise for this organization. There is no reason why CFJ cannot become financially self-sufficient. We will get there. It is going to take time and effort, but I am confident that whatever it is called, CFJ in the future will be a thriving entity.

Finally, CFJ’s immediate past president, Mark Garscia, as well as its new leadership team, are excellent, hard-working, dedicated volunteers. As this year progresses, LACBA’s leadership may find itself a target of criticism for our ongoing efforts to improve the association. While not apologetic, we are careful to note that the men and women who have volunteered their time for CFJ have done so much to make LACBA better. Change may take a little nudging and extra time, but, with respect for these people and all that they do, we can move into the future confidently.

The 2018-19 president of the Los Angeles County Bar Association, Brian S. Kabateck is founder and managing partner of Kabateck Brown Kellner LLP in Los Angeles where he practices in the areas of personal injury, insurance bad faith, pharmaceutical litigation, wrongful death, class action, mass torts, and disaster litigation.

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Madeline Bernstein  President, Society for the Prevention of Cruelty to Animals Los Angeles (spcaLA)

What makes you smile?  Pretty much everything

spcaLA was established in 1877. As president, what is your mission?  To prevent cruelty to animals. We do that through advocacy, intervention, education, mentoring, and anything else we can think of.

spcaLA is a local nonprofit organization. How big is the operation?  We have 90 to 95 people as staff and hundreds of volunteers. The budget is about $6 million.

Is the spca different from the ASPCA?  Yes, technically, ASPCA is the New York City SPCA.

How are you funded?  It is grass roots with merchants, restaurants, and wine sellers. The basic idea is take any children’s party and add alcohol. It’s a way more fun event than a stuffy sit-down.

No big galas?  Occasionally, but, very often, they have a low net return.

In 1979, you received your J.D. from the State University of New York at Buffalo. Why did you want to become an attorney?  One of my bachelor’s degrees is in Talmudic law, and my father was a lawyer. It’s the arguing, the big mouth—I thought I was pretty well suited.

Did you have an epiphany that led to this specialty?  First day of law school, first class, first 15 minutes: A gentleman in front of me had a guide dog. When my stomach growled, he hit his dog. I leaned over and told him, “That’s my stomach growling; stop hitting your dog.” He told me to “fuck off.” The growling and hitting continued. I got mad.

What facilities does spcaLA have?  Three adoption centers: Long Beach, Hawthorne, and Pico Rivera. We also have a training center in Burbank and an overflow facility next to our administrative offices in Los Angeles.

Puppy mills account for 2 million new dogs every year, while 1.2 million dogs are euthanized yearly. What is your shelter euthanasia policy?  Our policy is unless there is irremediable suffering or if the dog is too aggressive to safely place, it’s pretty much up to the dog or cat.

You have written an article titled “Preventing Shelter Liability with Adoption Contracts.” What is the one ironclad rule to accomplish that?  Full disclosure about everything you know about that pet.

You run humane education programs. What is the main issue you teach?  We teach love and compassion programs to at-risk youth. The schools select the kids. We’ve discovered that around middle school is your last chance to teach empathy. It is the missing ingredient.

Do the programs work?  When children are starting to take pleasure in hurting something that’s alive—if you can catch it early—you have the best chance.

Humane Officers are sworn personnel. What are their powers?  All powers as any peace officer while they’re on duty and within the scope.

You are also on the advisory committee of the Animal Cruelty Division of the Association of Prosecuting Attorneys? What is the most common crime against animals?  Extreme neglect.

Are these cases hard to prosecute?  It’s one of the few crimes where an omission counts as a commission.

Animal hoarders have a 99 percent recidivism rate. What’s the answer?  If the hoarding was triggered by an event, treat that—the underlying issue.

Have you been involved in cases with hundreds of cats in one home?  Yes. I’ve been in places with two hundred cats. Some were dead, some were buried under feces, some had open wounds, and some had burned paws from standing in urine.

Formalized in 1993, Disaster Animal Response Team is a mobile command post for services for animal victims of disaster. Has pet rescue improved?  Yes. After Katrina, there was an uproar that pets weren’t considered in the disaster planning. People were told they could not be rescued if they were going to take their pets.

Your website suggests a preparedness plan for pets. Such as?  Have a leash, a carrier, a muzzle, and a to-go kit.
Veterinary Public Health recommends rabies vaccinations? Are most dogs in Los Angeles vaccinated? Yes.

Pets are now welcome at a wide variety of retail establishments. Can’t they stay at home? We tell people, “Have your dog stay at home if there is no real reason for them to be with you.”

What about service dogs? People rely on these guide and service dogs, but the fake service dog is an issue, with people buying a fake service dog costume on the internet. It makes it harder on those with a need.

Is there a best pet for a family? No. Find a good, nice, and lovable dog who everyone feels safe with.

What makes an adoption successful? Involve the entire family.

What is your one piece of advice for the Average Joe pet owner? Love your pet.

What animals shouldn’t be pets that often are? Wolf hybrids, wild cat hybrids—Savannahs and Serval, and the exotics—monkeys, alligators, and poisonous snakes.

What is the most common cause of a pet dog’s death? Taking out cruelty and accidents, old age. Geriatric medicine for dogs is booming.

Some urban wildlife have adapted to living near humans. Have we adapted to them? No, we are self-centered. We develop and expect the animals to find a restaurant to eat at.

In 2011, your blog “This Bitch Craves Attention: Animal Welfare in Los Angeles” won the CBS People’s Choice award. Who’s the bitch? I’m pretty sure it’s me.

You have called tinier and tinier dogs “Instagram worthy.” Are they a problem? The teacup dogs can’t survive. They are adorable, but they are fragile.

In your book, Designer Dogs: An Exposé: Inside the Criminal Underworld of Cross-breeding, soon to be released, you wrote that our culture’s obsession with new types of dogs has led to a world of disposable pets. How? People are looking at a dog as an accessory. They look at a website and buy with a click. When the dog arrives and needs $10,000 in medical expenses, it’s abandoned.

Is there a humane way to kill the animals we eat? That’s always a discussion. Is the issue that you should not eat animals, or is the issue you should not eat animals who are inhumanely killed? If you make the animal treatment more humane, more people may eat meat. Then, you piss off the people that say do no harm.

What is your favorite restaurant? Ordering in pizza.

Are you a vegetarian? Mostly.

What personality trait of yours do you wish you could change? I would always like to go to the self-confidence store and get more.

What characteristic do you most admire in your mother? She’s a warrior.

What are your retirement plans? I am going to die at my desk.

If you were handed $10 million tomorrow, what would you do with it? Give some to spca, go off on a first-class, around-the-world trip, and share the rest.

Who is on your music play list? I’m locked in the sixties.

What book is on your nightstand? Understanding Variation: The Key to Managing Chaos.

Which magazine do you pick up at the doctor’s office? Vanity Fair. If the doctor is prompt, Vogue.

What is your favorite vacation spot? The Caribbean.

What do you do on a three-day weekend? Well, there’s bourbon.

What is your favorite spectator sport? Watching the Yankees.

What super power do you wish you had? Being invisible.

What is your go-to-outfit when making a public presentation? Black suit, high heels, and fish nets.

What are the three most deplorable conditions in the world? Places without food and water, injustice, and bullying.

Who are your two favorite U.S. presidents? Washington and Lincoln.

What is the one word you would like on your tombstone? Bitch.
Discoverability and Use of Evidence from Social Media Websites

UNDERSTANDING THE POTENTIAL USE of social media in litigation—as both a sword and a shield—is more important now than ever.1 While there are various aspects of social media to consider in terms of its relevance to litigation, the topic of discoverability of social media is particularly salient.

California case law governing the discoverability of social media content is still evolving. Federal authorities offer guidance, and in general, an individual’s social media content is discoverable—even if it is posted on a “private” account or is a direct message sent between two individuals or an Instagram.

For litigation purposes, social media posts qualify as electronically stored information, subject to the rules of civil discovery.2 Notwithstanding this general rule, courts disfavor fishing expeditions.3

Whether requests seeking social media information are relevant will depend on the claims or defenses of the case. A common example is requests for social media posts in personal injury actions that may reflect a contradiction of physical or emotional injury brought by a plaintiff.4

The court in Giachetto v. Patchogue-Medford Union Free School District, on the other hand, provided that “[a] plaintiff’s entire social networking account is not necessarily relevant simply because he or she is seeking emotional distress damages,” and that “the relationship of routine expressions of mood [in social media posts] to a claim for emotional damages is much more tenuous” than a relationship between a post “reflecting engagement in a physical activity” to a claim for personal injury damages.5

The case of Mailhoit v. Home Depot USA Inc., from the Central District of California, provides that in order to compel production of social media material, the requests must be sufficiently particularized to put the responding party “on notice of the materials to be produced” and be “reasonably calculated to lead to the discovery of admissible evidence.”6

Best Practices in Discovery

An attorney may attempt to ask for the entire contents of a user’s social media profile or page, but many courts will be reluctant to grant broad access. Instead, requests for specific posts are likely to be more successful. In addition, an attorney should ask the responding party to identify all platforms that he or she uses, as well as the related username and passwords. During a deposition, it is important to follow up with the deponent about the use of the account (What is the frequency?) and whether he or she has made any recent changes to it.

Further, a wide array of information can be gleaned from publicly available social media information about the opposing party and witnesses as well as one’s own client and experts. Most ethics authorities agree that lawyers may view publicly available information when investigating a matter.7

In my own practice, for example, I have been able to track down a witness I was having trouble serving with a deposition subpoena because she frequently traveled for work. Upon seeing her on public Instagram that she had posted a photo while hiking through Griffith Park, we attempted service on her again and it was successful.

Information a person posts online is ripe for consumption in both litigation and the court of public opinion, so it is increasingly important for individuals to be aware of the effect their social media presence can have on their own lives. For example, ABC cancelled Roseanne Barr’s television show hours after she tweeted racist remarks, and a small scandal erupted when the frontrunner on “The Bachelor” was found to have “liked” several alt-right and transphobic memes on Instagram.

It will be interesting to observe how social media etiquette and individual behavior will evolve, or whether the fact that social media can be used as a shortcut to exposing a person’s internal thoughts will have somewhat of a chilling effect on speech. In the interim, social media should not be an overlooked tool in an attorney’s arsenal. Through it, a wealth of information about an individual’s physical status or location at a certain time, as well as his or her thoughts and beliefs, can be ascertained.

7 See, e.g., Colorado Ethics Op. 127 (2015) (discussing the use of social media for investigative purposes, a lawyer “may always view the public portion of a person’s social media profile and any public posts.”).

1 Gillian H. Clow is an associate in the litigation and trial practice group at Alston & Bird LLP in downtown Los Angeles. She also serves on the LACBA Barristers Section as its social media chair.

Most ethics authorities agree that lawyers may view publicly available information when investigating a matter

Gillian H. Clow is an associate in the litigation and trial practice group at Alston & Bird LLP in downtown Los Angeles. She also serves on the LACBA Barristers Section as its social media chair.
BUSINESSES HAVE LONG RECOGNIZED the benefits of using a celebrity or “influencer” to market their products or services. As opportunities for direct engagement between influencers and the public grow through social media, so do the influencers’ abilities to impact the shopping habits of their followers. Realizing their growing impact on consumer behavior, many influencers are reconsidering traditional flat-fee compensation for their endorsement services in favor of equity (or equity equivalents) in the business they are promoting. From the company’s perspective, granting an influencer equity can be an effective tool to maximize the influencer’s incentive to promote the business with minimal cash outlay, but such arrangements must be carefully structured.

While there are many legal issues to consider in such an engagement (e.g., intellectual property rights, corporate governance issues, and Federal Trade Commission endorsement guidelines), ignoring tax considerations can greatly reduce an influencer’s economic benefit. As a business looks to hire an influencer, structuring an equity grant tax efficiently can prevent lost deductions and potentially reduce the amount of equity necessary to provide the influencer with equivalent economics.

At the outset, the influencer and the business must make various decisions regarding the structure of a “sweat-equity” deal. One threshold issue is the type of equity (or equity equivalent) to be granted. There are many types to choose from, and the type chosen can greatly impact the tax consequences to the company and the bottom-line to the influencer.

The choice of equity often is driven by tax considerations. The legal form of the company hiring the influencer (C-corporation, S-corporation, partnership, or limited liability company) often dictates the type of equity that can be issued. For example, C-corporations and S-corporations cannot issue “profits interests,” which can be disadvantageous to the influencer because profits interests are usually the most tax-advantaged form of equity to the influencer.\(^1\) Thus, choice of equity may be limited unless the business is willing to restructure its existing operations. If the influencer has enough negotiating leverage, a tax-efficient structure may be achieved to obtain his or her desired choice of equity.

The parties also need to negotiate when the equity will be received, i.e., will it be received immediately, over time, or when the company hits certain business metrics? A vesting schedule can be imposed on any type of equity, which is often a four-year schedule with a one-year cliff, but a quicker schedule may be appropriate in some cases.\(^2\)

In deciding choice of equity, the applicable tax rates must be considered to evaluate the net value to the influencer. On this point, significant changes went into effect pursuant to the 2017 Tax Cut and Jobs Act.\(^3\) For 2018, the highest marginal federal income tax rate on ordinary income for an individual taxpayer is 37 percent. If the taxpayer is a resident in California, the state and local income tax (SALT) rate may be as high as 13.3 percent for a combined effective income tax rate of over 50 percent (the federal deduction for SALT is no longer available in excess of $10,000).\(^4\) Thus, if the influencer is a tax resident of California, after taking into account both corporate-level taxes (now a federal 21 percent rate) and shareholder-level taxes, distributions from a C-corporation may be taxed at an effective rate of 65 percent.\(^5\) These potentially high tax rates make tax planning for any influencer engagement essential—particularly if the influencer resides in a high tax jurisdiction like New York or California.

If the business is a “qualified business,” payments with respect to equity may be eligible for the new 20-percent deduction on pass-through income, producing an effective tax rate of approximately 43 percent (assuming the taxpayer is a resident of California).\(^6\) The act did not impact tax rates on long-term capital gains, which remain at 20 percent for capital assets held

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for more than one year.

Given the large impact that tax can have on an influencer’s returns from an influencer engagement, the choice of equity is important to consider at the outset of the deal. Common types of equity include 1) straight equity, 2) restricted equity, 3) corporate stock options, 4) phantom equity, and 5) profits interests.

Straight equity is the grant of a current equity stake in the business. The company usually gets a deduction for the value of the equity grant, which is good for the company. Straight equity grants, however, are rarely used because the influencer will have current ordinary income equal to the value of the equity received. In addition, straight equity grants may not benefit the company if the company does not have sufficient taxable income to use the deduction. The influencer’s gain on a sale of the equity generally qualifies as long-term capital gain if held for more than one year.7

To mitigate the income tax “hit” to the influencer, the grant of straight equity may be coupled with a loan or a cash bonus to pay the tax. If a cash bonus is paid, the amount of the cash bonus is taxable so it also needs to be “grossed up,” which further increases the amount of the required bonus payment to the influencer, putting additional cash strains on the business. For this reason, the business may prefer to loan the influencer the funds to cover the influencer’s tax burden, while the influencer clearly would prefer a bonus.

Restricted equity is straight equity subject to certain restrictions, such as vesting and forfeiture. For example, a corporation may grant shares of stock to an influencer but provide that the influencer is entitled to the shares only if the influencer continues to provide services to the business for the applicable vesting period. Adding vesting is a common technique to ensure the influencer’s continued performance of his or her obligations under the engagement. It is common that equity grants to influencers be subject to a vesting schedule and a risk of forfeiture in the event the influencer terminates the agreement without good reason or is terminated by the company for cause. From a business perspective, there is risk to tying one’s brand to the reputation of a particular individual. Consequently, businesses may seek to have the definition of “cause” include the failure of the influencer to adhere to certain standards of conduct that are adverse to the company’s brand and corporate message (e.g., an athlete found to have been using performance-enhancing drugs).

From a tax perspective, neither the influencer nor the company has tax consequences at the time of the restricted equity grant.8 Instead, the tax consequences are deferred until the vesting conditions lapse (unless a certain tax election is made, which is referred to as a “Section 83(b) election”), and are determined in the same manner as they would be upon the grant of straight equity (i.e., taxable ordinary income equal to the fair market value of the vested stock at the time of vesting and a corresponding deduction to the business).9 The potential benefit of deferring recognition of income until the time of vesting is often outweighed by the fact that the business may appreciate dramatically over that time, resulting in a larger tax impact at the time of recognition—particularly in the case of emerging companies.

To mitigate such cost of deferral, the influencer may consider making a Section 83(b) election. If the influencer makes this election, the influencer can elect to disregard the vesting restrictions for purposes of determining his or her taxable income upon receipt of the restricted equity.10 In this case, the influencer would be required to recognize ordinary income equal to the value of the restricted stock on the grant date, not the vesting date.11 Any subsequent appreciation in value from the date of the grant may be eligible for the more favorable long-term capital gains treatment for federal income tax purposes.12 A Section 83(b) election generally is advisable if 1) on the date of the grant, the restricted stock has a relatively low value, and/or 2) the influencer expects the stock value to appreciate significantly during the vesting period. An 83(b) election should be considered anytime the influencer receives any form of equity that is subject to vesting or other substantial risk of forfeiture, including, but not limited to, a forfeiture for less than fair market value. It is critical that the election be made within 30 days of the grant date (and in some cases, from the date of a binding term sheet) or else the election cannot be made.

An option is a right to purchase equity of the company in the future. Generally, there are no tax consequences for the influencer, or tax benefits for the business, when an influencer is granted an option, as long as the strike price is equal to current fair market value. (Otherwise, the option grant may trigger adverse tax consequences to the influencer-recipient.)13 The applicable regulations do not specify how to determine fair market value, only that the valuation must be reasonable under the circumstances.14 Upon exercise, the influencer has taxable (ordinary) income equal to the difference between the fair market value of the equity and the exercise price of the option. As in the case of a straight equity grant, the influencer generally will come out of pocket to pay the tax (creating a liquidity need).15 To postpone this tax liability (and potential liquidity problem), option holders often do not exercise their options until there is a liquidity event (i.e., a sale of the business), which comes at a cost. Specifically, such postponement generally prevents the option holder from recognizing long-term capital gain because the holding period in the underlying stock will not exceed one year if exercised immediately before a sale.16

Note that under Section 83(i) (added by the act), different rules may apply with respect to certain stock options issued by corporations. Specifically, if certain criteria are satisfied, the influencer can defer the tax otherwise due upon the exercise of the stock option for up to five years.17 To satisfy the criteria, among other things, 1) the influencer cannot hold a 1 percent or greater interest in the company prior to exercise and cannot hold a position as a key officer of the company, and 2) the company must grant the option to the influencer in connection with his/her performance of services as an employee.18

Phantom equity is a contractual right to receive a certain percentage of company earnings or sale proceeds or both when non-phantom equity holders receive operating distributions and/or sale proceeds upon a liquidity event. For example, if the business hiring the influencer is a corporation, that corporation may grant the influencer “phantom stock” that gives the influencer a contractual right to a cash payment equal to the amount of cash that the holder of 1,000 shares of corporate stock in the company would be receiving upon a change in control event (i.e., a sale of the company). There are no tax consequences to either the influencer or the company at the time the phantom equity is granted.19

Although this arrangement may be administratively convenient for the company (not having to address voting, fiduciary, and other rights of the influencer as an owner), this costs the influencer the potential for long-term capital gain treatment upon an exit event, as the receipt of sale proceeds should be treated as ordinary income. Phantom equity may constitute nonqualified deferred compensation, and care should be taken to ensure that the phantom equity plan is compliant with Section 409A. Otherwise, the influencer may suffer catastrophic tax consequences, including acceleration of all deferred compensation subject to ordinary income tax rates, plus a 20-percent federal tax penalty,
A profits interest in a business taxed as a partnership gives the owner a right to share in future business profits but has no current liquidation value on the grant date.21 A profits interest has no current liquidation value if, in the event the business was sold on the grant date, the influencer would not be entitled to any share of the proceeds of such sale.22 The influencer generally is not taxed at the time of grant provided that, in addition to the liquidation value requirement, 1) the partnership is not publicly traded, 2) there is not a certain stream of income, 3) the influencer is treated as a partner from the date of grant, and 4) the interest is not disposed of for two years.23 A business generally can grant a profits interest only if, for federal income tax purposes, the business is taxed as a partnership immediately before, or would become a partnership immediately after, the profits interest grant.24 The business is not entitled to a deduction for the issuance of the interest.25 Although a Section 83(b) election may not be required for a profits interest if the foregoing requirements are satisfied, even if the profits interest is subject to vesting or other substantial risk of forfeiture, the influencer should consider making a “protective” election to protect against ordinary income recognition if the determined value of the company at the time of grant is incorrect or the interest is transferred within two years of the grant date.26

Similar to the phantom equity scenario, the influencer may share in operating distributions of the business with the other equity holders from the grant date. Unlike phantom equity, however, gain from a sale of a profits interest may be eligible for long-term capital gain upon a sale of the equity if the influencer’s holding period exceeds one year, except to the extent of gain attributable to certain “hot assets” (e.g., inventory and unrealized receivables) that is subject to ordinary income tax rates.27 For this reason, a profits interest tends to be a better choice for an influencer than phantom equity, provided that the partnership agreement is carefully drafted to protect the influencer’s interest as a partner in the business. Although the business does not receive a deduction upon a profits interest grant, the business receives the economic equivalent of a deduction because, to the extent that the influencer is entitled to current or future distributions from the business, the business would allocate a corresponding amount of income to the influencer (and away from the other members or partners of the business).

One potential downside to a profits interest is that the influencer does not participate in the prior appreciation of the business given the requirement that the profits interest has a zero liquidation value on the date of grant. To mitigate this result, the influencer may be able to negotiate what is referred to as a “catch-up feature,” i.e., a mechanism by which the liquidation waterfall will first give existing owners the first liquidation distributions equal to the value of the company immediately prior to the profits interest grant. The next tranche of liquidating distributions then goes entirely to the influencer until the influencer receives an amount to catch up as though he or she participated from dollar-one, and the remaining balance gets distributed to all members on a pro rata basis. The caveat is that the business must have appreciated enough to fully “catch-up” the influencer.

The recent tax reform legislation includes a provision that allows partners in partnerships a deduction of up to 20 percent of the entity’s “qualified business income” (subject to certain limitations based on the amount of W-2 wages that the company pays and the tax basis of certain tangible depreciable property), which is limited for specified service businesses, including performing arts, consulting, and athletics.28 Although a discussion of the requirements and limitations of the deduction is outside the scope of this article, if the business is a qualified business, the effective tax rate on pass-through income is substantially reduced; therefore, influencers generally should prefer a profits interest over phantom equity. The business, on the other hand, may prefer a phantom equity plan in order to increase the business’s W-2 wage base to maximize the deduction. There are structuring techniques, however, to accommodate both the influencer and the business under these circumstances.29

To the extent that the business is a C-corporation or an S-corporation, the grant of equity to an influencer is tax inefficient because 1) the grant of straight equity in this type of business is subject to ordinary income tax upon receipt by the influencer and 2) a conversion of the business to a limited liability company in order to grant the influencer a profits interest is a taxable liquidation of the business that may adversely impact the existing owners. If the influencer has sufficient negotiating power, structuring techniques are available to migrate the business to a limited liability company taxed as a partnership without liquidating the C-corporation or S-corporation.30 Once the business is migrated to a limited liability company, the business may grant a profits interest in the limited liability company and achieve the benefits described above.

In any event when the business is a pass-through entity (i.e., a partnership or S-corporation), it is important that the influencer negotiate mandatory “tax distributions” because a pass-through entity allocates currently taxable business income to its owners, which is subject to tax without regard to whether the business makes cash distributions to the owners (referred to as “phantom income”). To mitigate this result, it is important to negotiate mandatory tax distributions (preferably quarterly to pay estimated taxes), which are distributions intended to be sufficient for the influencer to pay any current tax liability. In addition, most partnership agreements provide for “drag” and/or “tag” rights, which, respectively, provide 1) a selling majority member (or members) a right to drag minority members along with them in a sale of the business or 2) minority members a right to tag-along in a sale by such selling majority member(s). It is important to draft carefully the drag and tag provisions to comply with the profits interest rules in order to maintain the influencer’s interest as a valid profits interest.

When structuring an equity deal between a business and an influencer, a common technique to force a sale to the company is the use of a put or a call option, which are important contractual tools to protect the influencer’s reputation, as well as the business’s brand. Because put and call rights may not be included in off-the-shelf agreements, the parties should ensure that these issues are adequately addressed in the written documents addressing the equity issuance and ownership.

A put right may be utilized to protect the influencer if the business engages in an activity that could potentially damage the influencer’s reputation. For example, an athlete who enters into an influencer deal with a vitamin supplement business that subsequently is investigated by the FDA may want to have a built-in eject mechanism to eliminate his or her involvement with the company immediately rather than wait until the FDA issue is resolved. Correspondingly, the business may want a similar feature to protect its brand if the influencer is involved in a publicized scandal, which may include a call right to purchase the equity from the influencer upon a specified date or event. In either case, the terms of any arrangement should specify the procedures for the purchase and sale of the equity, including the determination of the purchase price.
The terms of every deal are different, and the parties should carefully consider their tax benefits and liabilities and ability to exit the deal upon potentially harmful events or to accelerate liquidity.


2. A one-year cliff is a vesting stipulation, whereby it is agreed that if a partner quits or is terminated within the first year, the departing partner forfeits all of his/her equity.


4. Based on 2018 tax rates of 37 percent maximum federal and 13.3 percent California State. I.R.C. §1; REV. & TAX. CODE §17041.

5. I.R.C. §164.

6. See generally I.R.C. §199A (generally, any trade or business other than certain specified service businesses).

7. Note that gain from the sale of a partnership interest may be subject to ordinary income tax to the extent the partnership owns “hot assets” e.g., inventory and unrealized receivables.

8. See generally I.R.C. §83.

9. Id.

10. Id.

11. See I.R.C. §83(b).

12. Id.

13. Section 409A is a provision of the Internal Revenue Code of 1986, as amended, that applies to compensation earned in one year but paid in a future year. If an option is not exempt from Section 409A, an influencer may currently recognize as ordinary income the difference between the fair market value of the stock and the exercise price at the time of issuance. The influencer may be subject to a 20-percent penalty and 5-percent penalty for federal income tax and California income tax purposes, respectively.


15. If the option agreement provides, the exercise price can be paid in cash or by “net exercise” whereby the influencer uses a portion of the underlying stock to pay the exercise price (reducing the total amount of cash received by the amount of the aggregate exercise price).


19. Generally, a phantom equity is a right to receive W-2 wages payable concurrently when proceeds are paid to equity holders.


22. Id.

23. Id.

24. See id.

25. See id.


27. I.R.C. §751.

28. Note that sole proprietorships and shareholders of an S-corporation (but not a C-corporation) may also be eligible for the 20-percent deduction.

29. For example, a management holding company may be admitted as the direct owner of the business such that the business may pay the indirect owner W-2 wages.

30. For example, the S-corporation or C-corporation contributes the business to a limited liability company and admits new equity holders directly to the limited liability company.
Amazon’s Labor-Tracking Wristband Patents Raise Privacy Concerns

IN A POTENTIAL PATENT VERSION REPLAY of the recent Ninth Circuit “Blurred Lines” decision, courts may soon have to decide legal challenges to Amazon’s wristband patents for impermissibly blurring the line between humans and robots. The U.S. Patent and Trademark Office (USPTO) recently granted two patents to Amazon for wristbands capable of identifying the location of warehouse employees as well as controlling and directing their hands towards target inventory bins. The patents have caused a stir among privacy advocacy groups and employee rights organizations that have raised concerns about the patents’ potential for undue and illegal intrusion into employees’ privacy. These groups also have questioned the USPTO’s issuance of the patents and, in the event of an infringement suit by Amazon, whether the government can properly be empowered to enforce them.

As written, the patents have been carefully drafted to focus on identifying the location of storage bins and on measuring the relative positions of workers and bins and not on directing the employee’s hands towards the target bins. However, in their practical application, the patents allow employers to track every move made by their employees and control employees’ hands by sending signals to direct workers’ hands towards target bins and away from incorrectly approached bins. The legal community is monitoring developments for potential challenges relating to the validity of the patents, enforceability, conflict with state common law tort laws, and constitutional Fourth Amendment challenges for violating workers’ privacy rights.

Worker privacy advocates have warned that implementing the patented wristband technology and system will add another level of workplace surveillance amounting to undue intrusion into employees’ private actions and could provide employers with private information, e.g., when an employee pauses to scratch or takes a bathroom break. Others have pointed out that by controlling and directing human movements, the patents, in effect, treat employees as robots and violate accepted norms of behavior by blurring the line of interaction between humans and technology, specifically concerning robots.

The competing public and private interests in potential challenges to the Amazon patents are familiar and deeply rooted in law and tradition. Public interest in the advancement of science and technology is enshrined in the U.S. Constitution. The Patent and Copyright Clause authorizes Congress “to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.” Acting on that mandate, shortly after the birth of the nation, President George Washington signed the first federal patent statute, the Patent Act of 1790, into law.

Armed with the full force and power of the government, an issued patent is a powerful tool in the hands of an individual or organization to enforce the owner’s government sanctioned invention rights. Thus, patent law and policy often involve a fine balancing act between competing public interests. The concern with the Amazon patents is that implementation of the patents will result in gathering highly private information about the users. In addition, the patents challenge deeply held norms and expectations concerning the relationship between technology and humans.

The background section of the Amazon patents explains the aim of the inventions as addressing challenges facing inventory management systems in responding to requests for fulfilling orders. The patents point out that under conventional inventory management systems, incoming inventory items are stored in bins for quick and efficient retrieval of items in responding to an incoming customer order. The patents tout the importance of keeping track of the position of inventory bins relative to the workers to enhance the overall efficiency of the order completion process. The Amazon patents criticize existing processes for keeping track of inventory bin locations as uneconomic and inefficient but find proposed improvements in the form of a computer vision apparatus to track location of inventory bins inadequate as well as cumbersome and costly.

The Amazon patents propose a system using ultrasonic communication to track employee hand movements that can evaluate and enhance task performance for inventory workers. According to Amazon’s abstract of the invention, the patented inventory management utilizes radio frequency-based tracking of a worker’s hands to monitor performance of inventory tasks. The disclosed system includes inventory bins, a user-wearable unit (wristband) configured to be worn on a user’s hands, antennas for sending and receiving radio frequency signals that track locations of the wristbands and identify inventory bins based on proximity to the worn wristband. Ultrasonic pulses are emitted at predetermined intervals to track the relative position of the worker’s hands and the target inventory bins. According to the Amazon patents, this will help determine if the worker interacted with the correct bin and will allow the system to direct the worker’s hands toward the correct bin by sending a pulse to the wristband to alert the worker when the worker’s hands are in close proximity to a target bin, also altering and redirecting the user’s hand if it is moving towards the incorrect bin.

Amazon has explained that under current practice its workers track the movement of items from shelves into bins using handheld scanners, and the aim of the patents is to simplify and enhance efficiency of the current system. Amazon has downplayed concerns about the patents’ potential for invading worker privacy as overblown, seeking instead to portray the patents as an incremental improvement in enhancing productivity and efficiency of order fulfillment by freeing employees’ hands and eyes from scanners.

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and computer screens.

Even though the USPTO has determined that the Amazon wristband system is eligible for patent protection, questions have been raised about whether the USPTO exceeded its authority in issuing the Amazon patents. Such questions have been raised before, and courts have intervened to invalidate whole categories of issued patents as “subject matter ineligible.” For example, in 2013, when considering validity of issued gene patents, U.S. Supreme Court Justice Elena Kagan commented, “The PTO seems very patent happy.”10 The Supreme Court subsequently found genes not to be eligible subject matter for patent protection.11 The issue here is whether courts will find the subject matter of Amazon patents, at least as it applies to human control and directing, to be subject matter ineligible.

An option for courts addressing validity of the Amazon patents is to find them unenforceable when acting on humans, a result that would take the government out of enforcement of the patents in specific applications, making them effectively available for all to use. Precedent for such action was set when Congress enacted legislation to render medical processes unenforceable under certain circumstances. At issue was a patented medical process shortening the duration of cataract surgery and eliminating the use of stitches. Later, the patent owner filed suit against a medical group for infringement of his patented medical process.12

Physician advocacy groups intervened in the court action, arguing that enforcing medical method patents ran against public policy of encouraging physicians to disclose and share their treatment techniques.13 In addition, they said enforcing such patents would hamper physicians from offering the best treatment to their patient. The groups expressed concern that in a court action to enforce their patent rights, patent owners would impermissibly invade the privacy of patients by seeking access to their medical records. In response to these concerns, Congress passed an amendment to U.S. patent law, which provides that a medical practitioner’s performance of a medical activity, defined as the performance of “a medical or surgical procedure on a body” that constitutes an infringement of an issued patent will not be held liable for damages and will not be enjoined from practicing the medical procedure claimed in the patent.14

Another potential challenge to the Amazon patents is to their validity based on failure to meet the “moral utility” requirement. Under the patent statute, the three basic requirements for eligibility of an invention for patent protection are: utility, i.e., that the invention has a practical application and is more than an abstract idea; novelty, meaning that the invention is new and did not exist before; and non-obviousness, meaning that there are meaningful differences between the invention and what came before it.15 “Moral utility” is an aspect of the requisite utility for patent eligibility. The judicially created doctrine of “moral utility,” devised long ago, states that for an invention to be “useful,” it cannot conflict with the “sound morals of society.”16 According to this doctrine, “All that the law requires is that the invention should not be frivolous or injurious to the well-being, good policy, or sound morals of society.”17

The doctrine, which had fallen out of favor, has been revived to some extent. For example, the court in Geneva Pharmaceuticals, Inc. v. GlaxoSmithKline PLC noted that a patent possesses utility “if it will operate to perform the functions and secure the results intended, and its use is not contrary to law, moral principles, or public policy.”18 A challenge to the validity of the Amazon patents for lack of moral utility is plausible on the basis that they impermissibly violate privacy and dignity by effectively treating humans as robots.

The most serious legal hurdle to implementation of the Amazon patents on workers may be its potential conflict with the privacy guarantees of the Fourth Amendment. The Patent and Copyright Clause of the Constitution authorizes Congress to grant inventors and authors exclusive rights to their respective inventions and works of authorship for limited periods of time. Patents currently enjoy a 20-year monopoly period. Patent rights are enforceable through courts. Available remedies include injunction and monetary damages.

The U.S. Constitution contains no express right to privacy. However, the Supreme Court in numerous decisions since the 1920s has relied on the Bill of Rights to carve out certain rights based on privacy considerations. These rights include privacy of a person’s freedom from unreasonable search and seizure under the Fourth Amendment. Patents, issued and enforced by the government, cannot violate other constitutional requirements, such as those of the Fourth Amendment. Moreover, the standards of the Fourth Amendment have been adopted in state privacy laws, which extend to private employer conduct.

The legal debate concerning the trade-off between privacy and efficiency in the workplace is not new. Common worker monitoring techniques, including cameras in the workplace, employer monitoring through access to employee e-mails and Internet browsing have been around since at least the 1990s. However, such concerns have come into renewed focus with the Amazon patents as they potentially cross the generally accepted bounds of surveillance and monitoring of employees into the uncharted territory of directing and physical control of humans.

The U.S. Supreme Court has confirmed that Fourth Amendment rights are protected in the workplace to guarantee “privacy, dignity and security of persons against certain arbitrary and invasive acts” by employers.19 In its 2010 landmark decision in City of Ontario v. Quon, the Supreme Court identified certain factors for courts to consider in deciding whether employer intrusion on employee privacy rights passes legal muster. These factors include 1) whether the employee has a reasonable expectation of privacy in the area covered by the technology, 2) whether the employer has a legitimate work-related rationale for the intrusion, 3) whether the intrusion is reasonable in scope, 4) availability of less intrusive means to achieve the same purpose, and 5) public acceptance of the complained of conduct.20

In City of Ontario, the city had provided its employees with pagers for emergency communication. The city’s employee policy manual made clear that the city had the right to access and monitor communications to and from the city-issued pagers and that employees should have no expectation of privacy or confidentiality in the pagers’ use. When Jeff Quon, a city employee, repeatedly exceeded the monthly character limit for use, the city ordered an audit of his communications to determine if the usage was work-related. In conducting the review, the city discovered most of the text messages sent by Quon were not work-related but personal, and many were sexually explicit. The city proceeded to implement disciplinary measures against Quon, who responded by filing suit against the city for violating his Fourth Amendment rights.21

Addressing the particular facts and circumstances of the case, the Supreme Court allowed for a certain extent of privacy in communications on the pagers provided by the city but concluded that expecting complete privacy would not be reasonable since Quon had been informed of the potential auditing of his messages and that his position as a law enforcement officer indicated his likely awareness of scrutiny of his actions and that such scrutiny may involve examination of his communications during the work hours. The Court also considered the facts and circumstances of
the search and concluded that the search of the Quon’s messages was motivated by a proper purpose, which was to determine “whether the character limit on the city’s contract with [vendor] was sufficient to meet the city’s needs” and that it was tailored to the problem at hand and was reasonable in scope “because it was an efficient and expedient way to determine whether Quon’s overages were the result of work-related messaging or personal use.” The Court then found that the review had not been overly intrusive, even though less intrusive means of obtaining the same information may have been available.

In an earlier decision, the Supreme Court stated that “a Fourth Amendment search occurs when the government violates a subjective expectation of privacy that society recognizes as reasonable.” Therefore, a key question in a Fourth Amendment violation inquiry is whether society accepts the conduct complained of as reasonable. In that regard, the Supreme Court has recognized that the legal standard needs to be in accord with public acceptance of the tradeoff between the intrusive effect of new technology and the resulting efficiency in productivity. Taking their cue from the U.S. Supreme Court, other federal and state courts generally have been cautious about establishing “broad precedents as to privacy rights vis-a-vis electronic devices and emerging technologies” because of “the difficulty in determining what privacy expectations are reasonable.” In *City of Ontario*, the Supreme Court cautioned that “[t]he judiciary risks error by elaborating too fully on the Fourth Amendment implications of emerging technology before its role in society has become clear.” The Supreme Court thus consciously avoided setting forth “a broad holding concerning employees’ privacy expectations vis-a-vis employer-provided technological equipment.”

The Amazon patents also may run afoul of state privacy laws, such as the common law tort of “intrusion” in effect in California. The California Supreme Court has linked the reasonableness of privacy expectations under the law to such factors as 1) the identity of the intruder, 2) the extent to which other persons had access to the subject place, and could see or hear the plaintiff, and 3) the means by which the intrusion occurred. Relevant factors in determining whether the alleged intrusion is “highly offensive” under the particular circumstances include the degree and setting of the intrusion, and the intruder’s motives and objectives. The California Constitution protects privacy rights of individuals against both government and nongovernmental actors and provides a right of action for violations against both private and government entities. To prevail, the party seeking relief must meet several requirements. First, the complainant must possess “a legally protected privacy interest,” such as “conducting personal activities without observation, intrusion, or interference,” as determined by “established social norms.” Second, the alleged expectations of privacy must be reasonable, based on “customs, practices, and physical settings surrounding particular activities.” Third, the plaintiff must show that the intrusion by its “nature, scope, and actual or potential impact as to constitute an egregious breach of the social norms.”

The person or entity accused of the violation can defend itself by providing a justification for the intrusion. Courts then must balance the competing interests by applying “general balancing tests.” To the extent the plaintiff raises the issue in response to a claim or defense of competing interests, the defendant may show that less intrusive alternative means were not reasonably available.

Amazon’s patented technology is vulnerable to challenge under federal and California privacy laws for its capability to collect much personal information concerning the location and movements of employees who wear the wristbands, much of which can objectively be considered to be private. In addition, there is the potential for inadvertent gathering of information on workers. Regardless of its purpose, the obtained information could put the employee at risk. For example, a company could fire a worker if they are found to be performing tasks slower than coworkers.

While the final result of these expected challenges cannot be predicted with any degree of certainty, public acceptance of the trade-off between increased efficiency and productivity and worker privacy and dignity will play a large role in the fate of the Amazon patents and other similar patents that will inevitably surface in the coming months and years.
BRING IT HOME

On a global level, tax reform may prove selective and variable regarding taxable C corporations versus individual and other noncorporate taxpayers.

The Tax Cuts and Jobs Act,1 signed by President Donald Trump in December 2017, now fully in effect, is changing the international tax system foundationally, adding further complexity in that area. The act professes to transform the U.S. international taxing system from a global one—which taxes worldwide income—to a territorial one—which taxes only U.S. source income. However, the reality is that the new provisions tax on a quasi-territorial basis at best. Switching to this hybrid tax system is anticipated to be disruptive, taxing not globally but selectively and, as written, is complex in application. Practically, different types of income and taxpayers are now taxed even more differently than before, and the contrast is particularly pronounced when comparing taxable C corporations with individual and other noncorporate taxpayers.

One of the act’s other primary goals is to discourage U.S. businesses from shielding taxable income through low-taxed foreign operations or investments and instead encourage them to maintain business assets—especially intangible assets—in the United States while exporting their products and services. In an increasingly globalized economy, these shifts in policy have a material impact on businesses and individuals since key changes in the act often create contradictory economic incentives for those who transact business internationally. Overall, the application and interaction of the numerous changes to the Internal Revenue Code’s international tax provisions remain unclear in many important respects, and guidance has been sporadic at best.

The act attempts to accomplish its objectives by, among other things, imposing a one-time transition tax on previously deferred foreign income, a current and on-going tax on certain foreign income, a tax break for select exports, and limits...
on deductions of payments between U.S. companies and their foreign affiliates.

**Major Changes**

Historically, the United States taxed worldwide income, meaning U.S. residents and corporations were taxed on all income earned globally. Whether an individual or business was subject to U.S. tax on its global earnings depended on whether the individual was a U.S. resident and whether the business entity was organized in the United States. Key factors in determining U.S. income tax liability with respect to international activities of these taxpayers included the location, type, and frequency of their business activity; location and type of business assets; and the source and nature of their income. Escaping this residency-based regime was not a simple process, which led to complex tiered-entity structures generally involving foreign entities.

The related tax rules allowed U.S. corporations to defer payment of tax on income earned abroad by using foreign corporations that sheltered this income from current U.S. taxation. Subject to limited anti-deferral rules (e.g., the Subpart F rules applicable to controlled foreign corporation (CFCs) that, though located abroad, had a certain requisite level of U.S. shareholder ownership), the United States taxed income earned in foreign corporations to their U.S. shareholders only when funds were actually paid out to these shareholders. Thus, active business income earned overseas in a foreign corporation could generally stay there untaxed until it was brought to the United States. Additionally, U.S. corporate shareholders traditionally received a credit for foreign taxes paid on this distributed income and thus did not have the income double-taxed.

The Subpart F anti-deferral rules caused certain categories of generally more passive investment-type income earned abroad by the CFC to be taxed currently to U.S. shareholders even when they did not receive a current distribution of such income. The Subpart F rules are among the most complex in the Internal Revenue Code and have now taken on a renewed and different importance. Traditionally, being deemed Subpart F meant a higher tax rate applied—even on income that has not been distributed—but Subpart F income now is sometimes ultimately taxed at a lower rate than that which applies under the new post-reform provisions to other types of foreign income.

The act materially modifies how the United States now taxes U.S. residents and corporations, nominally aiming to tax them on a territorial basis, meaning that only U.S.-sourced income is taxed. The act provides incentives to encourage U.S. businesses to keep assets and investments in the United States rather than abroad. However, this concept is not consistent throughout the act, and overseas income is often taxed currently. Moreover, credits for foreign tax paid partially or completely disappear, at times increasing the overall tax due. Thus, while the underlying concepts of tax reform are straightforward, as applied in the act, they are not. Furthermore, changes involving the continued taxation of low-taxed foreign income may in extreme situations lead to double taxation. This occurs because certain credits are lost while new taxes are added to income earned abroad or otherwise connected to a U.S. shareholder.

**Dividend-Received Deduction**

One of the principal means for creating a territorial international tax system is an increased dividend-received deduction (DRD). The DRD provides for no tax on a qualifying dividend payment received. Corporate shareholders who are residents of the United States traditionally have received a foreign tax credit for foreign income taxes that the foreign corporation paid on distributed profits. This “indirect” foreign tax credit is now gone. While this deduction provision was meant to eliminate U.S. taxes on overseas earnings, as written it has a narrow impact and some of its benefit is overridden by other provisions of the act.

A 10-percent U.S. corporate shareholder now gets a DRD for the full foreign-source portion of a dividend it receives; thus, it pays no U.S. tax on the actual dividend distribution. This change essentially means that a 10-percent U.S. corporate shareholder’s dividend income earned outside the United States is not taxed in the United States. A tax credit basically ensures that no double tax is paid in different countries on the same income. With the indirect foreign-tax credit eliminated, the excluded dividends cannot be taken into account when computing a U.S. shareholder’s foreign tax credit limitation. Further, no deductions for foreign withholding taxes on the distribution can be taken. Only narrow types of earnings fall within this deduction provision, and a minimum 366-day holding period applies. Thus, many prior advantageous tax provisions no longer apply for a large number of shareholders.

Additionally, the scope of this new “territorial” tax system is very limited. The DRD deduction does not apply if the foreign company is a CFC, restricting who benefits from this deduction. The territorial tax system is entirely a C corporation concept. Therefore, S corporations, individuals, and other noncorporate taxpayers are not eligible to receive the DRD deduction and will still pay their normal tax rate on any distributions. The effective date relates to distributions after December 31, 2017.

**Transition Tax**

The act imposes new taxes on foreign income that are inconsistent with a purely territorial system. One of the most immediate impacts of the act is a one-time “transition tax” on foreign earnings retained abroad and not yet subject to U.S. tax. The transition tax is a tax payment on earnings held overseas and not yet subject to U.S. tax; thus, it is levied on shareholders of a deferred foreign income corporation. The financial impact of this transition tax is material. Roughly $2.6 trillion of deferred earnings, depending on estimates, have been kept overseas to avoid U.S. taxation. The intent behind the legislation seems to be that these earnings, once taxed, can then enter the United States to be used for investment and growth here.

These foreign earnings, which are earned indirectly through “specified foreign corporations” retained offshore and not distributed by January 1, 2018, and not yet taxed by the United States, now get collectively taxed. This income will be taxed to corporations at a 15.5 percent rate on cash and cash equivalents, and at 8 percent on less liquid assets (for individuals and other noncorporate U.S. taxpayers, at 17.5 and 9.05 percent, respectively, with S corporations being curiously alone in their ability to elect to defer this income acceleration).

Shareholders are able to elect to pay the tax over eight years. The deferred foreign income is the greater amount of such income as determined as of November 2, 2017, or, alternatively, as of December 31, 2017, (curiously without referring to the end of the fiscal year date of foreign corporations with noncalendar fiscal years). Payment of the elected transition tax installments is accelerated if a taxpayer pays late, or sells or substantially liquidates the corporation. This concept is similar to acceleration on sale clauses in shareholder or employment contracts.

Specified foreign corporations whose shareholders are subject to the transition tax include CFCs and any other foreign corporation that has one or more U.S. corporations, which is a defined U.S. shareholder (i.e., owning directly, indirectly, or by attribution 10 percent by vote or value...
of the foreign corporation). But once there is a specified foreign corporation, all such U.S. shareholders—whether corporate or noncorporate domestic shareholders—are taxable on their pro rata shares of the specified corporation’s deferred, accumulated foreign income at the aforementioned rates. Once taxed, the foreign corporation’s distribution of these accumulated earnings avoids taxation a second time upon its distribution as previously taxed income. Previously taxed income is an amount earned that has already been deemed to have been taxed by the United States (regardless of whether it was actually distributed) and, thus, will not again be subject to U.S. tax.

A domestic corporation receives an indirect foreign tax credit for the foreign corporation’s foreign income taxes associated with the taxable percentage of the specified corporation’s deferred, accumulated foreign income at the aforementioned rates. Once taxed, the foreign corporation’s distribution of these accumulated earnings avoids taxation a second time upon its distribution as previously taxed income. Previously taxed income is an amount earned that has already been deemed to have been taxed by the United States (regardless of whether it was actually distributed) and, thus, will not again be subject to U.S. tax.

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GILTI
The act adds a new tax, under the global intangible low-taxed income (GILTI) provisions, that provides a minimum tax on certain types of foreign income earned by a CFC after allowing for a 10-percent return on specified assets. Thus, income does not escape immediate U.S. tax, even though it is taxed favorably. This provision of the act’s new international tax rules is intended to bring low-taxed offshore income into the U.S. tax base rather than having it be excluded as a result of the DRD deduction. The effect of the GILTI provisions is to make the new international tax regime at best a quasi-territorial tax system. Practically speaking, income that is earned overseas is still being subject to partial U.S. tax.

A new category of currently taxed Subpart F income created under the act, GILTI is essentially income of a CFC that exceeds a nominal return of 10 percent on tangible assets. The 10-percent return that is calculated on the aggregate adjusted tax base of the CFC’s tangible assets—but not its intangible assets—is first allowed, and, then, any excess return over this 10-percent level of return becomes an additional Subpart F inclusion. A U.S. corporation, including GILTI, receives a deemed foreign tax credit based on foreign taxes paid by the CFC on this income. The deemed foreign tax credit is subject to an 80-percent limitation and is only partially creditable. Thus, even high-taxed foreign income is subject to U.S. taxation if it exceeds the threshold of 10-percent of tangible assets.

A minimum tax is imposed by GILTI on a U.S. shareholder’s share of the CFC’s active earnings that qualified for deferral under previous law but were subject to full taxation (after the indirect foreign tax credit, which avoided double taxation) upon repatriation (or deemed repatriation under the transition tax). Related amounts are calculated on a global—not territorial—basis. A U.S. shareholder of a CFC includes in income its GILTI as part of its Subpart F income. Timing differences between U.S. and foreign laws can result in recognizing GILTI for U.S. tax purposes before foreign tax credits for foreign taxes paid on the income are available, potentially resulting in a double tax, even without regard to the 80-percent limit on the foreign tax credit. Further, an individual or other noncorporate CFC shareholder is taxed on his or her share of GILTI at ordinary tax rates without the benefit of the 50-percent deduction of foreign-derived intangible income (FDII). This also results in a preferential rate for corporate shareholders, with individuals and pass-through entities not getting an equivalent break.

FDII
The FDII provisions establish a tax break for services and intangible derived income earned from overseas sales by U.S. corpo-
rations. The act provides, in effect, significant tax breaks to domestic corporations’ earnings from offshore exports of tangible and intangible assets, foreign services, and other specified foreign income. FDII, despite its name, is not directly traced to intangible assets. Rather, in broad terms, a U.S. corporation, with foreign sales and/or providing services to persons outside the U.S., computes a deemed tangible income return by multiplying the adjusted basis of its depreciable business property by 10 percent. This net deemed tangible return is the same 10 percent as computed under GILTI. The resulting amount is deducted from the corporation’s defined total income to arrive at the deemed intangible income. The deemed intangible income is then allocated to arrive at foreign derived intangible income, which is based on the ratio of net income from foreign sales and services to total net income (in both cases excluding Subpart F income, dividends, and certain other items). Thus, FDII is based on income from the sale of property (including leases and licenses) to foreign individuals for their use, disposition, or consumption outside of the United States and services performed by a person or for property outside the United States. A U.S. corporation includes FDII in gross income and then takes a related deduction.

Specifically, a U.S. corporation—but not a noncorporate taxpayer—gets a deduction related to these types of income after December 31, 2017, and on or before December 31, 2025, which equals the sum of 50 percent of its GILTI (including the IRC Section 78 gross-up for its deemed-paid foreign taxes under the Subpart F rules indirect-foreign tax credit) and 37.5 percent of the FDII. For tax years after 2025, the deduction percentages are reduced to 37.5 percent for GILTI and 21.875 percent for FDII. The effective corporate tax rate on GILTI is thus 10.5 percent (based on the 50-percent deduction) until 2025 and 13.125 percent after that (based on a 37.5-percent deduction), while the effective tax rate on FDII is 13.125 percent through 2025 and 16.406 percent thereafter. The FDII- and GILTI-related deductions, as calculated, cannot exceed the corporation’s taxable income. Overall, these provisions ensure that certain shareholders will receive preferential treatment on certain types of foreign-related income. Given that many multinational businesses are no longer heavy on tangible assets, how these provisions impact any given taxpayer may vary greatly.

These two categories—GILTI and FDII—not only complicate tax calculations but also ensure that a U.S. tax is paid, however not without controversy. As noted above, domestic corporations can deduct 37.5 percent of their earned offshore FDII. This income includes services provided to those outside the United States and sales of property abroad for use outside the United States. As a result of this deduction, a corporate tax rate of 13.125 percent (i.e., 62.5 percent of 21 percent) is assessed against a domestic corporation’s exports, which provides a substantial indirect export subsidy for U.S. services and product exports. This effect has not gone unnoticed by major U.S. trading partners, the Organization for Economic Cooperation and Development and the World Trade Organization. Consequently, retaliatory responses from our foreign trading partners are brewing.

**BEAT and Hybrid Transactions**

The act has additional provisions to ensure that income relating to foreign operations does not inappropriately reduce U.S. taxation, again a worldwide income taxation concept, not a territorial one. These provisions are aimed at ensuring that larger corporations can no longer use excessive deductions for expenses paid to related foreign entities to reduce U.S. tax.

The base erosion anti-abuse tax (BEAT) addresses, and potentially limits, outbound payments and is meant to prevent earnings-stripping through foreign affiliates. Earnings-stripping entails a U.S. company using deductible expenses, such as interest, with impunity to effectively lower its U.S. tax payments. With BEAT, large multinationals are more limited in their ability to make intercompany payments to reduce U.S. tax.

BEAT can generate additional tax liability by limiting the deductibility of certain payments between a U.S. subsidiary and a related foreign entity. The types of payments between the related parties that are limited by BEAT include interest, royalties, rents, service fees, the acquisition of property from a related party subject to depreciation or amortization, a premium paid among related parties for reinsurance payments, and the cost of goods sold for a company that inverted to become foreign after November 9, 2017. An inversion occurs when a U.S. and foreign corporation merge, with the place of incorporation for the combined company becoming that of the foreign entity, which typically has a lower tax rate. Under the act, the cost of doing business between related entities is now higher. However, to the extent that full—generally 30-percent—foreign tax withholding is imposed on a base erosion tax payment, the BEAT limitations do not apply.

To calculate the tax due, the related party payments are added back to income, which is then subjected to BEAT to impose a minimum tax liability upon the offending domestic corporation. This tax is imposed at a 10-percent rate (5-percent for the first taxable year beginning in 2018) upon the taxpayer’s so-modified taxable income, reduced by its adjusted regular tax liability. There is no BEAT liability if the domestic corporation’s regular tax liability exceeds its 10-percent BEAT tax.

A minimum tax triggered by certain related-party deductible payments, BEAT creates the possibility of a double tax: taxation in full in the recipient’s jurisdiction without allowing for a full deduction in the United States. Still, it only applies to taxpayers with annual gross receipts of $500 million or more and related party deductible payments equaling over three percent of overall deductions. No grandfathering provisions appear available to protect current related party payments under pre-act transactions or structures. In addition to the BEAT limitations, the IRC now provides that no deduction is allowed for any “disqualified” related party amount paid or accrued as part of a hybrid transaction or for any such payment by or to a hybrid entity. Related party amounts, thus disqualified, include those interest or royalty payments for which there is no income inclusion to the related party under local, foreign law or when the related party is allowed an offsetting deduction under local, foreign law. A hybrid transaction is one treated differently for U.S. versus foreign tax purposes. Specifically it is a transaction or other arrangement generating interest or royalties under U.S. tax law but not interest or royalties to the payment’s recipient under the laws of the country in which they are subject to tax. A hybrid entity is one treated as either transparent for U.S. tax purposes or as transparent under the laws of its country of residence for tax purposes but not under both sets of laws. Thus, when companies are operating in multiple jurisdictions, they may now end up paying a tax price, previously avoided under creative foreign, hybrid structures.

**Attribution Rule Changes**

Another international tax change under the act affects the attribution rules that control who is considered a U.S. shareholder of a CFC. More taxpayers will now be subject to U.S. tax on a CFC’s Subpart F income even when they do not receive any actual payments. The act repealed IRC Section 958(b)(4), which prohibited so-
called “downward entity attribution.”

This change essentially alters the ownership attribution rules used to determine if stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of deciding if the foreign corporation is a CFC for U.S. tax purposes. Coupled with the change of the definition of a U.S. shareholder, this attribution rule change now requires downward attribution of shares in a foreign corporation to partnerships, estates, certain trusts, and corporations from their foreign interest-holders.

As a result of the foreign corporation becoming a CFC, or a U.S. interest-holder’s becoming a U.S. shareholder of the CFC—due to the new attribution rule—U.S. taxpayers may need to pay U.S. tax on the foreign corporation’s Subpart F income, including GILTI. However, this attribution only applies for purposes of determining if a foreign corporation is a CFC. The CFC’s Subpart F income, which a U.S. shareholder must include in gross income, is still determined based on direct or indirect ownership of the CFC, without the new downward attribution rules being applied. Previously, U.S. shareholders only indirectly tied to other owners or entities could more easily avoid CFC status thereby being subject to the U.S. Subpart F taxation regime.

The changes are also retroactive.

The amendments to Section 958(b) apply starting with the last taxable year beginning before January 1, 2018, or, for a calendar year foreign corporation, its 2017 tax year. One perceived abuse that the repeal of Section 958(b)(4) was intended to address concerned the situation in which a wholly owned domestic subsidiary and its foreign parent corporation each own 50 percent of another foreign corporation. Prior to the repeal, the other foreign corporation was not a CFC as to the domestic subsidiary. After the repeal, there is downward attribution to the domestic corporation of the parent’s stock in the other foreign corporation, so as to increase the domestic subsidiary’s ownership of the other foreign corporation to 100 percent, thereby causing the other foreign corporation to become a CFC.

This change does not necessarily subject the U.S. shareholder to U.S. tax on the CFC’s foreign earnings. Rather, the U.S. shareholder must directly or indirectly own stock for it to include in gross income a share of the CFC’s Subpart F income. Thus, in the example above, the domestic subsidiary must treat the other foreign corporation as a CFC, but it will still pick up only 50 percent of the other foreign corporation’s CFC income, including its 50 percent share of the other foreign corporation’s GILTI income. Again, whether a U.S. taxpayer will need to pay tax on income from overseas, whether directly or indirectly tied to that taxpayer, has become a more fact-specific determination.

Additionally, the repeal of the prohibition on downward entity attribution could also subject U.S. taxpayers to the act’s transition tax. As a result of the downward attribution of foreign-company shares, a foreign company that was not previously a CFC can become one. Overall, potentially more complexity and more tax due will attach to taxpayers who formerly were outside the reach of the Subpart F rules.

These international tax provisions obviously cross practice areas, impacting corporate, noncorporate, and even largely domestic taxpayers. Due to the interrelationship among the changes to both international and domestic tax provisions, how major business enterprises and sophisticated individuals structure their holdings should now receive careful review in light of the dramatically changed advantages and disadvantages of different structuring options. Since the act applies policy in complex ways, tax professionals can prospectively utilize the new provisions to their clients’ benefit. However, given the new provisions’ potentially wide-ranging impact and uncertain application, those engaged in international transactions should be careful when making planning decisions.

The amorphous nature of the new provisions require that regulations and more guidance are urgently needed to clarify the complexities and uncertainties related to the application of the act’s international provisions. Expert tax advice has become even more key when dealing with international tax issues, both on an individual and corporate level.

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4 Subpart F income is an exception to the deferral rules for foreign derived income. Subpart F income only applies to CFCs, and relates mostly to passive income. A CFC is, in general terms, a foreign corporation in which U.S. persons own over 50 percent of the corporation’s stock, measured by vote or value.
6 Id. at 366.
7 Id. See I.R.C. §951 et seq.
8 I.R.C. §902 repealed by the act, §14301(a); cf. I.R.C. §960 (Subpart F indirect foreign tax credit remains).
9 I.R.C. §§245A(a), 951(b) (defining “United States Shareholder”).
10 I.R.C. §904(b)(5).
11 I.R.C. §245A(d).
12 I.R.C. §246(c)(5)(A).
13 I.R.C. §965.
14 Hufbauer, supra note 3.
15 I.R.C. §965(c)(1) provides the term “specified foreign corporation,” which means any CFC and any foreign corporation, in which one or more domestic corporations is a U.S. shareholder (10 percent corporation).
16 For purposes of I.R.C. §§951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under §965(a), I.R.C. §965(c)(2). However, if a passive foreign investment company (as defined in I.R.C. §1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. I.R.C. §965(c)(3), I.R.S. Notice 2018-07.
17 I.R.C. §965.
18 I.R.C. §965(c).
19 I.R.C. §965(i).
20 I.R.C. §965(h).
21 See I.R.C. §951(b), as amended by the act, §14214(a).
22 See I.R.C. §959.
23 The indirect foreign tax credit under §902 was repealed but only with respect to tax years beginning after Dec. 31, 2017. Tax Cuts and Jobs Act §14301(a).
24 See I.R.C. §965(g), which limits the foreign tax credit to the percentage of the accumulated earnings taken into income under the transition tax computation.
27 I.R.C. §951A.
28 Rather than referring to the new international tax regime in the act as a quasi-territorial system, it might be better to refer to it as an immediate worldwide income, anti-deferral tax system with preferred tax rates for export income.
30 I.R.C. §951A(a).
31 See I.R.C. §960.
32 I.R.C. §960(d)(1).
33 I.R.C. §250(b)(4).
34 I.R.C. §250(b)(4), (5). This deduction also appears to be allowed to a U.S. corporation owned by non-U.S. persons.
35 I.R.C. §250(a).
36 I.R.C. §250(a)(1).
37 I.R.C. §250(a)(3).
38 I.R.C. §250(a)(3).
39 I.R.C. §250(a)(2).
41 I.R.C. §250(a)(1).
43 I.R.C. §59A.
44 I.R.C. §59A(d).
46 I.R.C. §59A(b)(1).
49 I.R.C. §267A.
50 I.R.C. §267A(b).
51 I.R.C. §267A(c).
52 I.R.C. §267A(d).
53 Tax Cuts and Jobs Act, §14213.
55 This designation now includes by vote or value. I.R.C. §951(b), post-act amendment.
56 I.R.C. §958.
57 I.R.C. §951(a)(2).
The concept of the workplace has been evolving for decades. From automation obviating many traditional manufacturing jobs to the advent of flexible work schedules, the ability to work from home, and increased informality of many office settings, the workplace of today looks very different from the traditional brick-and-mortar locations of generations past.

The latest evolution of the American workplace is the ever-expanding, on-demand “gig” economy—freelance workers paid for discrete tasks or projects rather than receiving a traditional salary or hourly wage. It is estimated that more than 16 million people are now working in “contingent” or “alternative work arrangements” in the United States, and the number is growing.

At the center of this expanding gig economy, the issue of employment misclassification—treating employees as independent contractors—has become a recurring theme inside and outside the courtroom.

In April, the intersection of the right to contract for services and the state’s interest in protecting workers from those contracts dramatically shifted with the California Supreme Court’s decision in Dynamex Operations West Inc. v. The Superior Court of Los Angeles County. This far-reaching decision, which overturns nearly three decades of precedent, significantly expands the definition of employee under the California Wage Orders and positions the burden squarely on employers to prove that independent contractors are being properly classified.

With the rise of the gig economy and the 2017 Tax Cuts and Jobs Act, the stakes have never been higher for employers and workers alike regarding the distinction between independent contractors and employees. For employers, the recently enacted Tax Cuts and Jobs Act has eliminated the ability to deduct unreimbursed

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work-related expenses as miscellaneous deductions on their personal tax returns. Previously, employees were permitted to deduct these unreimbursed work-related expenses subject to certain income limits. Thus, for workers who incur significant work-related expenses, classification as an employee may result in meaningful tax repercussions. On the other hand, while independent contractors may initially see larger take-home incomes, not being classified as an employee typically means the loss of key employee benefits, worker’s compensation protection, protection from laws governing the employer-employee relationship (including minimum wage and maximum work-week rules), and higher tax liability.

**Employee Benefits**

For businesses, employees often represent an increased cost of more than 30 percent in the form of vacation time, worker’s compensation coverage, payroll taxes, and other benefits typically not given to independent contractors. Businesses are also liable for certain types of acts committed by employees in the course of their employment and must adhere to strict requirements relating to non-discrimination, discipline, and termination. The Patient Protection and Affordable Care Act (ACA) has also played an incentivizing factor in many employers’ preference for independent contractors. Specifically, under the employer mandate of the ACA, businesses with more than 50 full-time employees are required to provide health coverage for those employees or face significant penalties. This requirement does not, however, apply to independent contractors. Simply put, employees cost employers far more than independent contractors do.

Despite the many financial incentives for any employer not to classify workers as employees, misclassification also poses significant risk. Employers who misclassify workers as independent contractors become liable for taxes that should have been withheld. Likewise, criminal, civil, and administrative penalties may be imposed on employers who fail to abide by applicable labor laws and wage orders. Notwithstanding these severe ramifications, however, the proliferation of the on-demand economy has resulted in the distinction between employees and independent contractors becoming increasingly difficult to determine. For example, in February 2018, GrubHub, a food delivery service, was found to have properly classified a delivery driver as an independent contractor rather than an employee under California law. On-demand ride services such as Uber and Lyft also have found themselves constantly at the forefront of debate over the employment classification of their drivers. Exacerbating this difficulty, employment classification continues to be an ever-evolving area of law driven by a complex, yet decisive, distinction between those workers providing services as employees and those acting as independent contractors.

For nearly 30 years, the *Borello* test—a multifactor test enumerated by the California Supreme Court in 1989—served as the seminal guide for determining whether a worker was an independent contractor or employee. In *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, an agricultural grower challenged a penalty imposed by the California Labor Commission for failure to secure workers’ compensation coverage for their harvester employees. The grower argued that the Labor Commission had improperly imposed the penalty at issue as the harvesters were “share farmers” and thus independent contractors, not employees. Siding with the Labor Commission, however, the California Supreme Court ultimately concluded that the harvesters were indeed employees. The court reached this determination after evaluating a number of factors including: 1) whether the grower had a “right to control” the manner and means of the work completed; 2) the grower’s right to discharge the workers; 3) whether the workers were engaged in a distinct occupation or business; 4) the nature of the work performed; 5) the skill required in the particular occupation; 6) whether the grower or the harvesters supplied the instrumentalities, tools, and the place of work; 7) the length of time for which the services were to be performed; 8) method of payment; 9) whether the work was part of the regular business of the grower; and 10) whether the parties believed they were creating an employer-employee relationship.

**Right to Control**

Analyzing these various factors, the court identified the right to control as the most significant element in determining employment status. Further, the court found that in the instant case, the grower had indeed maintained “pervasive control” over the operation through, among other activities, selecting the produce to be farmed, cultivating the land throughout the growing cycle, and transporting the harvested crops to market. As such, the court concluded that the harvesters were indeed employees and, in doing so, gave life to a multifactor test emphasizing the manner in which work is performed as the determinative analysis of employment status in California.

In 2008, the California Supreme Court further clarified the employment landscape in *Martinez v. Combs*. Unlike *Borello*, the *Martinez* case did not concern the issue of worker classification as an employee or independent contractor. Rather, *Martinez* arose in the context of the defendants’ argument that they were not employers under California law and, as such, focused on the meaning of the terms “employer” and “employee” as used in the context of California wage orders.

**Defining Terms**

In *Martinez*, seasonal strawberry harvesters brought suit against their direct employer and also their employer’s distributors to recover unpaid minimum wages under the California Labor Code. The distributors initially obtained summary judgment under the theory that they were not employers under the definition of the applicable Industrial Welfare Commission wage orders. On appeal, the California Court of Appeal affirmed the grant of summary judgment, employing the “economic realities” test of the Fair Labor Standards Act to find that the distributors had not exercised sufficient control over the harvesters to constitute employment. On further appeal, however, the California Supreme Court rejected the federal economic realities test as a means of defining employment status and held instead that that the Industrial Welfare Commission’s definition did, in fact, apply. Specifically, the supreme court held that wage orders embody three alternative definitions of “employ”: 1) the exercise of control over wages, hours, or working conditions; or 2) suffering or permitting the work; or 3) creating a common law employment relationship through engagement. Focusing on whether the distributors at issue had suffered or permitted the harvesters’ work, the court ultimately found that they had not and, therefore, were not liable as employers. However, the court made clear that its newly endorsed expansive definition of “employ” might not foreclose liability in other cases in which a typical employer-employee relationship was not present.

Four years after *Martinez*, the California Supreme Court once again found itself presented with the question of employment classification in *Ayala v. Antelope Valley Newspapers, Inc.* In *Ayala*, newspaper carriers filed a wage-and-hour action against the Antelope Valley Press alleging that the newspaper had misclassified them as independent contractors rather than as employees. The trial court initially denied
MCLE Test No. 281

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1. In California, minimum wage laws generally apply equally to employees and independent contractors.
   True.    False.

2. The court in Dynamex Operations v. Superior Court of Los Angeles County expressly held that its new “ABC” test is applicable to establishing employment status under the California Fair Employment and Housing Act.
   True.    False.

3. The ABC test classifies workers who perform tasks consistent with the employer’s usual course of business as employees.
   True.    False.

4. Employers who misclassify workers as independent contractors are liable for employment taxes that should have been withheld.
   True.    False.

5. The so-called Borello test presently remains the standard for determining employment status for purposes of employers’ workers’ compensation insurance requirements.
   True.    False.

6. No presumption is made under the Dynamex ABC test as to a worker’s employment status unless that worker can first establish the employer has violated a California wage order.
   True.    False.

7. In Martinez v. Vons, the California Supreme Court adopted an “economic reality” test as the standard for defining employment status.
   True.    False.

8. The first element of the ABC test—being free of the control and direction of the employer—is largely a reiteration of the common law Borello test.
   True.    False.

9. The ABC test was adopted by the Dynamex court as an attempt to simplify employment classification determinations.
   True.    False.

10. Workers may be classified as independent contractors rather than employees so long as they consent to such classification at the time of their employment.
    True.    False.

11. Dynamex further expands the broad definitions of “employ” and “employer” set forth in Martinez.
    True.    False.

12. An employer’s “usual course of business” for purposes of analysis under the Dynamex ABC test is determined exclusively by statute.
    True.    False.

13. Agricultural harvesters, delivery drivers, and electricians are all cited by the Dynamex court as examples of workers likely engaged in a sufficiently independent trade so as to justify independent contractor status.
    True.    False.

14. A worker can be simultaneously classified as an employee under California law but as an independent contractor under federal law.
    True.    False.

15. With respect to determining an employer’s degree of control over a worker, only actual control is determinative.
    True.    False.

16. The Dynamex court’s adoption of the ABC standard is modeled after a substantially similar Massachusetts test.
    True.    False.

17. The fact that a worker has taken steps to incorporate his or her own business supports a likelihood that the third element of the ABC test can be met.
    True.    False.

18. The ABC test does not alter the definition of independent contractor under federal law.
    True.    False.

19. California’s courts are generally reluctant to classify workers as employees rather than as independent contractors.
    True.    False.

20. In the aftermath of Dynamex, exempt workers in California are the most likely group to require reclassification.
    True.    False.

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3. □ True     □ False
4. □ True     □ False
5. □ True     □ False
6. □ True     □ False
7. □ True     □ False
8. □ True     □ False
9. □ True     □ False
10. □ True    □ False
11. □ True    □ False
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15. □ True    □ False
16. □ True    □ False
17. □ True    □ False
18. □ True    □ False
19. □ True    □ False
20. □ True    □ False
the plaintiffs’ motion to certify the action as a class action on the ground that under the Borello standard, common issues did not predominate on the question of whether the plaintiffs were independent contractors. On appeal, however, the court of appeal disagreed in part, and reversed the trial court’s finding that employee status could not be established without “heavily individualized inquiries.”19

On review, the California Supreme Court limited its analysis solely to the common law test and affirmed the ruling of the court of appeal that Borello did not preclude class certification in the instant case. Specifically, the supreme court opined that by focusing on variations in how the newspaper exercised control over its carriers rather than on the newspaper’s right to control the work itself, the trial court had “lost sight” of whether the scope of the newspaper’s right of control was sufficient to permit class-wide assessment.20 Notably, while the court in Ayala did find the Borello standard to be the proper test in evaluating the class certification issues presented in that case, the court did not address whether in a class action alleging misclassification of employees, a class may be certified based on the definitions of “employ” and “employer” as construed in Martinez, or whether the Borello test represented the only standard for distinguishing between employees and independent contractors in this setting. Indeed, this question would go unanswered for roughly four more years until 2018, when the court would take it up in Dynamex.

**The Dynamex Decision**

On April 30, 2018, the California Supreme Court once again dramatically changed the course of California’s employment landscape through its decision in Dynamex. In Dynamex, parcel delivery drivers brought suit against their employer, claiming that they were being incorrectly classified as independent contractors rather than employees. As a result of this misclassification, the drivers claimed that Dynamex violated provisions of a California Industrial Welfare Commission Wage Order as well as various sections of the Labor Code.

After litigation in which the trial court’s order denying class certification was reversed by the court of appeal, the trial court ultimately certified a class of delivery drivers. The trial court, however, rejected Dynamex’s contention that in the wage order context, as in most other contexts, the Borello test is the sole standard for distinguishing employees from independent contractors and, instead, based its certification order on the expansive definition of “employ” set forth in Martinez. Dynamex subsequently challenged the class certification, asserting that the Martinez definitions of “employ” and “employer” were inapplicable to the issue of whether the drivers were employees or independent contractors; rather, Dynamex argued that those definitions are relevant only to the distinct joint employer question that was directly addressed in Martinez.

The court of appeal rejected Dynamex’s contention and concluded that the wage order definitions discussed in Martinez are indeed applicable to the employee or independent contractor question for purposes of wage orders. The court of appeal, however, also concluded that with respect to those causes of action that are not governed by wage orders, the Borello test was the applicable standard for determining whether a worker is properly considered an employee or an independent contractor. Dynamex then appealed to the California Supreme Court.

Ultimately, the issue that came before the California Supreme Court was whether the definitions of “employ” and “employer” as discussed in Martinez were applicable to the question of whether a worker is properly classified as an employee or an independent contractor for purposes of wage orders. In determining that the trial court had not abused its discretion in certifying the class, the court held that the broadest possible interpretation of these definitions should apply, and thereafter adopted a new ABC test closely modeled after Massachusetts’ own version of this standard.21

As a starting point, the new Dynamex ABC test presumes that all workers are employees unless the employer is affirmatively able to prove otherwise. Importantly, the burden of demonstrating independent contractor status falls squarely on the business, not the worker. Specifically, a business must meet a three-pronged test to establish independent contractor status: 1) The company must not be able to control or direct what the worker does, either by contract or in actual practice; 2) the worker must perform tasks outside of the hiring entity’s usual course of business; and 3) the worker must be engaged in an independently established trade, occupation, or business.22

The first element—being free of the control and direction of the employer—is in many respects quite similar to the common law Borello test. Under Borello as well as the newly articulated ABC test, a worker who is either by contract or by practice subject to the type and degree of control a business typically exercises over employees is likewise considered an employee. In order to meet this part of the test, workers must be free from the employer’s right of control; actual exercise of that control is, however, not necessary.23

**Departure from Borello**

While the first prong of the ABC test is familiar, the subsequent two elements represent a prominent departure from Borello. The test’s second prong—performance of tasks outside of the employer’s usual course of business—seeks to exclude from independent contractor status those workers who are providing services in a role comparable to that of an employee. To satisfy this second element, an employer must demonstrate that the worker’s job is separate and distinct from the employer’s ordinary course of business, and not a regular or continuous part of that business.24 Under prong B, almost any worker who engages in the same business as its employer will be classified as an employee.

In an attempt to lend clarity to this second element, the court provides examples of workers it considers to be independent contractors as opposed to employees. The court said plumbers and electricians who provide their services to a retail store would not be considered performing work within the store’s usual course of business. As such, the court concludes that these workers could properly be classified as independent contractors.25 On the other hand, the court cites the example of a work-at-home seamstress hired by a clothing manufacturer to make dresses from materials supplied by the company and that will thereafter be sold by the company as someone who would likely be considered an employee.26

These simplistic examples notwithstanding, the court provides little practical analysis of how an enterprise’s “usual course of business” is actually to be determined. Although the court offers the example of a retail store that engages a plumber to repair a leak or an electrician to install a new line, nowhere does the court define the usual course of business of a retail store other than simply concluding in a cursory fashion that the services of the plumber and electrician are not part of the store’s usual course of business.27 Practitioners and courts are thus left to navigate a wide range of statutes and case law in an attempt to define the scope of an employers’ business. For example, California Labor Code Section 2810.3 defines “usual course of business” as “the regular and customary work of a business, performed within or upon the premises or worksite of the client employer” while Section 3355 defines “course of trade, business, profession, or
occupation” to be “all services tending toward the preservation, maintenance, or operation of the business, business premises, or business property of the employer.” Indeed, the question of what constitutes the usual course of business will undoubtedly be the subject of future litigation.

The third and final prong of the new Dynamex test seeks to identify those workers that have taken steps to create their own businesses. To that end, this C prong requires independent contractors to be “customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.” Workers who have independently made the decision to go into business for themselves are likely to be found as satisfying this third prong.

If, on the other hand, they are “simply designated as an independent contractor by the unilateral action of a hiring entity,” it is likely that they will be found to be employees.

Notably, prong C represents the most problematic of the three prongs to decipher. While the court cites plumbers and electricians as basic examples of possible independently established trades, it remains unclear how many gig economy workers—e.g., dog walkers, web developers, or stylists—would fit into this model. A related but similarly unaddressed issue is the status of loan-out corporations under prong C. A loan-out company is a business entity in which an individual is typically the sole owner and the employee who furnishes his or her personal services to outside parties.

This arrangement is especially prevalent in the entertainment industry although loan-out agreements do occasionally appear in other industries such as real estate. Because loan-out companies often consist of a single individual, these businesses often do not engage in the same level of enterprise formalities as do other corporations. For example, loan-out companies may not advertise or otherwise actively promote the business.

Yet, the Dynamex court explains that the C prong of the ABC test is generally provable by evidence that the worker in question has taken “the usual steps to establish and promote his or her independent business—for example, through incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like.” Especially in the case of loan-out companies and other small businesses, the question of what activities are truly necessary to constitute “usual steps to establish and promote” the business are critical threshold questions that remain unanswered by Dynamex.

Similarly, while the court, by its language, suggests that an independent contractor must already be engaged in his or her own business to meet the third prong of this new test, it is unclear exactly how established that business must be to qualify. After all, every business has a first client. The C prong’s narrow language nevertheless suggests that initial customers may potentially face misclassification liability if the contractor fails to attract subsequent clients. If this is so, the chilling effect of this decision on small businesses and entrepreneurship as a whole may prove highly significant.

Taken as a whole, under the new Dynamex standard, employers may not engage an individual as an independent contractor unless that worker has established an independent business to provide services that are unrelated to the employer’s own course of business. Although the court professes that its adoption of the ABC test will “create a simpler, clearer test for determining whether the worker is an employee or an independent contractor,” in many respects the 82-page opinion has created more questions than answers.

All is not lost for employers, however. Importantly, the court did limit applicability of the ABC test in Dynamex to determining whether workers should be classified as employees or independent contractors for purposes of California wage orders promulgated by the Industrial Welfare Commission. Thus, Dynamex does not alter the definition of independent contractor under federal law and, because at present the Dynamex test applies only to wage orders, this means that generally only nonexempt employees are impacted for the time being. As to determining employee status for purposes of workers’ compensation, unemployment compensation, or reimbursement of expenses under the provisions of the labor and unemployment codes, it appears that, at least for now, the common law Borello test remains applicable. How long this may stay the case, however, remains to be seen. For example, while Dynamex does not presently expressly apply to the California Fair Employment and Housing Act (FEHA), like wage orders, the FEHA is remedial legislation that consistently receives broad interpretation by courts in this state. As such, it is easy to imagine the Dynamex ABC test being applied in the future to the FEHA and other remedial statutes as the standard for determining employment status. Thus, in the future it is increasingly likely that individuals may be independent contractors under state law but not for federal purposes such as Social Security and payroll taxes.

Of course, while many of these distinctions are relevant in the context of litigation, from a practical standpoint, businesses cannot realistically choose to classify a worker as an independent contractor for some purposes and as an employee for other purposes. When deciding to categorize a
worker as an employee or independent contractor, the ABC test is thus ultimately determinative in California despite its profession narrowly scope. Moreover, the Supreme Court’s reasoning in *Dynamex* appears driven, in large part, by the court’s apparent preference for traditional full-time employment arrangements as a means of extending maximum legal protections to workers whenever possible. The result—whether intended or not—of the court’s approach in *Dynamex* is that the cost of doing business in California just increased for numerous businesses. Moreover, given the court’s strong recent endorsement of this protectionism, it is likely that in time the *Dynamex* test may also be utilized in determining how workers are classified in other contexts as well. Irrespective of whether *Dynamex* remains limited to wage orders, it is clear that this decision will have a lasting impact on business in California and that many, if not most, employers will need to re-examine their use of independent contractors to determine whether reclassification is necessary.

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6 LAB. CODE §1199 (misdemeanor punishable by a monetary fine, imprisonment, or by both, for failing to pay at least minimum wage or requiring employee to work in manner prohibited by the Industrial Welfare Commission).

7 LAB. CODE §1193.6a (Department of Industrial Relations may commence and prosecute a civil action to recover unpaid minimum wages or unpaid overtime compensation owing to any employee); LAB. CODE §1194a (employee receiving less than minimum wage or legal overtime compensation has right to recover in a civil action any unpaid balance, with interest, reasonable attorney’s fees, and costs of suit); LAB. CODE §1194.2 (in action to recover wages because of payment less than the minimum wage, employee shall be entitled to recover liquidated damages in an amount equal to the wages unlawfully unpaid plus interest).

8 LAB. CODE §1193.5 (Department of Industrial Relations may investigate and ascertain wages, hours, and working conditions of all employees in the state and may supervise payment of unpaid minimum wages or unpaid overtime compensation owing to any employee).

9 *Lawson v. GrubHub*, Inc. 302 F. Supp. 3d 1071 (N.D. Cal. 2018). Notably, however, because this case was decided prior to the decision in *Dynamex*, the court’s analysis followed *Borello*.


11 Id. at 351.

12 Id. at 356.


15 *Martinez*, 49 Cal. 4th at 66.


17 “A proprietor who knows that persons are working in his or her business without having been formally hired, or while being paid less than the minimum wage, clearly suffers or permits that work by failing to prevent it, while having the power to do so.” *Id.* at 457.


19 Id. at 544.

20 Id. at 534.

21 *Dynamex Operations W. v. Superior Ct.*, 4 Cal. 5th 903, 956-57.

22 Id.

23 Id. at 935, 958.

24 Id. at 958-62.

25 Id. at 959.

26 Id. at 959, 960.

27 Id.

28 Id. at 917.

29 Id. at 962.

30 Id.

31 Id. at 950 n.20.
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So observed the editor of a libertarian publication in May 2013. Not long afterward, however, the U.S. Department of Justice began its active shutdown of dark web marketplaces and investigations into individuals who use and operate them. In October 2013, the FBI shut down Silk Road, the first and most famous marketplace operating on the dark web—a series of websites accessible through a special browser that allows users and operators to remain anonymous. Since their inception, dark web marketplaces have been a platform for buying and selling illegal drugs in addition to any and all black market items. The founder of Silk Road, Ross Ulbricht, was convicted on charges of engaging in a continuing criminal enterprise (the Kingpin statute), narcotics trafficking, money laundering, and computer hacking. He was sentenced to life in prison without the possibility of parole.

Upon Silk Road’s shutdown, dark web vendors and users relocated to other sites. The two largest successors, AlphaBay and Hansa Market, were recently shut down by law enforcement and their operators arrested. In July 2017, when the founder and administrator of AlphaBay, Alexandre Cazes, was arrested, his laptop was open and logged into AlphaBay, allowing authorities to gain access to all of the website’s hidden servers and financial accounts. That same month, the U.S. Attorney’s office issued a 21-count indictment against Alexander Vinnik, a Russian citizen believed to be the operator of the digital currency exchange, BTC-e, which handled more than $4 billion in unlicensed bitcoin exchanges as a means for laundering money.

Nina Marino is a partner, and Jennifer Lieser and Casey Clark are attorneys, at Kaplan Marino in Beverly Hills. The firm specializes in complex criminal and white collar matters.

[T]his is something special about Bitcoin that makes it inherently resistant to government control. It is built on code. It lives in the cloud. It is globalized and detached from the nation state, has no...institutional owner, operates peer to peer, and its transactions are inherently pseudonymous. It cannot be regulated in the same way as the stock market, government currency markets, insurance, or other financial sectors.1

To shut down illicit dark web markets and their criminal currencies, the feds have been largely successful relying on old-fashioned police work.
Money laundering prosecutions have long been an effective tool in the government’s law enforcement arsenal. Attacking the criminal proceeds that sustain contraband operations on the dark web proves to be no exception. During 2012 and 2013, when Silk Road was operational, the estimated value of the transactions was over $1.2 billion given the 2012-13 rate of bitcoin, with around 900,000 users per day worldwide. A financial investigation into dark web marketplaces like Silk Road means going after Bitcoin and “examining the ways that individuals and criminal organizations earn, move, store, and launder their illicit proceeds.”

The once hidden and unregulated dark web is at the forefront of the government’s investigative efforts. Of particular interest is the currency used to facilitate these dark web transactions: Bitcoin.

What is Bitcoin?

Bitcoin is the most dominant form of decentralized convertible digital currency, or “cryptocurrency.” The Bitcoin network, created less than a decade ago, was conceptualized as a value transfer system. Bitcoin was the first and is now the most widespread, readily accepted cryptocurrency; however, there are currently over 900 “Altcoins” or “virtual currencies.” Digital currency is generally defined as an electronically sourced unit of value that can be used as a substitute for fiat currency. The pseudonymous digital currency is not issued, nor is it backed, by any government, bank, financial institution, or company but is instead generated and controlled through computer software operating on a decentralized peer-to-peer network. Users maintain their bitcoin on an electronic wallet, which may be kept either on their computer or through an online wallet service such as Coinbase. Each wallet is accessed using both the public and private key. The public key operates in the same manner as a username or e-mail address and the private key as a password.

Bitcoin is not stored in any physical form, rather, it exists within a record of transactions. Its operation as a peer-to-peer network facilitates the creation and maintenance of a public ledger, known as the “blockchain.” The blockchain is a public record of all Bitcoin transactions permanently maintained in chronological order. Each transaction is recorded on a block with both transactors’ public keys (or wallet addresses) and is independently verified through a process called “mining.” Both parties authorize the transaction using their private keys.

While Bitcoin operates like money on a digital platform, it fails to meet the definition of currency. Money, as termed by the U.S. government, is “the coin and paper money of the United States or of any other country that [1] is designated as legal tender and that [2] circulates and [3] is customarily used and accepted as a medium of exchange in the country of issuance.” Bitco in, on the other hand, is not financially backed or regulated by any governmental agency and transcends borders as a global currency solely operating on a peer-to-peer network. Bitcoin, by its very design, makes it attractive for illicit transactions, so much so that it has been termed “criminal currency.” Bitcoin has been viewed as a powerful tool for criminal activity because it can function as a means to move and store illicit funds while circumventing regulatory and law enforcement scrutiny. Because it is not backed by any country or central bank, there is no central authority or oversight body. The difficulties in tracking and tracing funds create inordinate challenges for law enforcement as there are no readily accepted or widely recognized mechanisms to pinpoint the particular acts involved in laundering funds or to impede their progression.

Bitcoin is characterized by its pseudonymous nature, which means that it is entirely anonymous other than the owner’s public key on the blockchain—which can simply be changed with each transaction through the creation of a new account. Bitcoin transactions can be further camouflaged through the process of “bitcoin tumbling” or “bitcoin mixing,” a process by which the user’s bitcoin is sent through a complex series of dummy transactions in order to create a disconnect between the sender (user) and the receiver on the blockchain. The user’s privacy is safeguarded because Bitcoin is based entirely on and backed solely by peer-to-peer transactions, thus making law enforcement detection and investigation challenging. The individual’s identity remains anonymous as long as the wallet address remains unconnected to its user.

Users of Bitcoin may access dark websites operating on The Onion Router, or TOR network, which is a publicly downloadable router network designed to conceal the Internet Protocol address for the users. This network protects the privacy of its users and, in so doing, serves to conceal the identity and location of those using Bitcoin on the dark web. In fact, law enforcement typically orchestrate searches and takedowns to try to catch a suspect while he or she is working on a laptop. The second the laptop shuts, the information is likely encrypted and extremely difficult to retrieve.

Dark web marketplaces, like Silk Road and AlphaBay, operate as a platform for buying and selling goods and services. These dark web platforms conceptually emulate an actual marketplace with multiple vendors selling any illegal item imaginable. The government is fighting what seems to be a never-ending battle against these dark web marketplaces, for as one gets shut down, numerous others pop up to fill the void.

Often Bitcoin is the only source of currency used and accepted in these marketplaces. In order to convert funds that are generated by illicit activity from bitcoin to dollars, users utilize the services of a bitcoin exchange. A licensed money transmitter is an unlikely option for those conducting business on the dark web because licensed money transmitters must comply with and report to the Financial Crimes Enforcement Network (FinCEN). Unlicensed exchanges such as Alexander Vinnik’s BTC-e allow users to maintain anonymity throughout the currency exchange process. In this type of transaction, both the user seeking to convert the currency as well as the unlicensed money transmitter are subject to criminal prosecution.

Regulatory Framework

The lack of a universal definition or conception for Bitcoin has forced each regulatory agency to classify it through the lens consistent within its own purview. Nevertheless, whether through a formal policy announcement or through a case of first impression, each of the four agencies has ultimately found that it can, indeed, regulate Bitcoin.

The most significant in terms of enforcement is FinCEN, a bureau within the U.S. Treasury Department that is charged with implementing, administering, and enforcing compliance with the Bank Secrecy Act (BSA) and the first agency to address precisely how virtual currencies fit within its area of governance. Despite the fact that FinCEN distinguished virtual from real currency, it still found that those who operate as administrators or exchangers of virtual currency are money services businesses (MSBs) and therefore subject to BSA regulations, including registration, reporting, and recordkeeping requirements.

The other federal agencies serve to establish regulatory guidelines. The Internal Revenue Service classifies virtual currencies for federal taxation purposes as property, similar to stocks and bonds as opposed to currency. The Commodity Futures Trad-
ing Commission has determined that the definition of a commodity within the Commodities Exchange Act is broad enough to encompass Bitcoin. 

Finally, the chairman of the Securities and Exchange Commission issued a December 2017 statement classifying cryptocurrencies as purported "items of inherent value (similar, for instance, to cash or gold) that are designed to enable purchases, sales and other financial transactions." 

The breadth of each regulatory agency’s singular focus on oversight and regulation has as much potential to open doors to defenses as it does to close them. Despite the unique challenges arising from the inherent structure of Bitcoin—in addition to the need for international cooperation and the difficulties in obtaining user records—in November 2013, during a congressional hearing, the Department of Justice stated its intention to include Bitcoin within the current anti-money laundering regulatory framework. Thus far in its regulation, the DOJ has relied upon its current—yet outdated—definitions of money services businesses and money transmission as well on anti-money laundering (AML) statutes that are also outmoded. The government targets dark web vendors who exclusively sell contraband in exchange for bitcoin and those who use unlicensed money transmitters to convert the bitcoin into cash.

Because of the decentralized nature of Bitcoin, the easiest and most effective way to regulate virtual currency is to regulate the bitcoin exchanges since these are subject to the BSA. The BSA requires financial institutions, namely MSBs, to assist government agencies in detecting and preventing money laundering. 

The enactment of the USA PATRIOT Act broadened the scope of the BSA with Title III of the act—the Intentional Money Laundering Abatement and Anti-Terrorist Financing Act of 2001—expanding the number of AML obligations imposed on money transmitters. Among these requirements are AML compliance programs, customer identification programs, due diligence, mandatory information-sharing with federal law enforcement, and monitoring, detecting, and filing reports of suspicious activity.

Money transmitters conducting exchanges with individuals on the dark web remain unlicensed in an attempt to avoid detection by and compliance with these stringent reporting requirements, opening themselves up to criminal culpability as an unlicensed money transmitter in violation of Section 1960 under Title 18 of the U.S. Code.

Typically, the money transmitter is distinct from the dark web vendor. The most common charging scheme involves prosecution of money laundering in violation of Sections 1956 and 1957 of the code. The criminal enterprise may be additionally prosecuted for conspiracy as well as the underlying criminal activity, which typically involves the distribution of controlled substances.

**Money Laundering Statutes**

While Bitcoin operates like currency, it does not have the legal characteristics of real currency, namely, it does not have legal tender status. Therefore, it is not surprising that much of the current case law (of which there is very little and is almost exclusively prosecuted out of the New York district courts) focuses on the question of whether Bitcoin fits within the current constructs of the money laundering statutes.

In order to decide whether criminal activity involving Bitcoin may be prosecuted under the traditional money laundering statutes, the district courts have unanimously determined that the issue turns on whether the definition of Bitcoin falls within the ordinary meaning of “funds” as interpreted under Sections 1956 and 1960.

However, the courts diverge in their application of these statutes to Bitcoin and, more specifically, in what actually constitutes the ordinary meaning of “funds.”

The line of cases stemming from *United States v. Ulbricht* have determined that Bitcoin falls within the meaning of “funds” because “money” and “funds” are synonymous, and the general understanding of money is as a medium of exchange—to which Bitcoin qualifies, thus making it subject to the money laundering statutes.

However, in *United States v. Petix,* a magistrate judge in the Western District of New York determined the opposite, finding that Bitcoin does not fall within the ordinary meaning of “money” and therefore could not be prosecuted under the money laundering statutes because money gains its value from its connection to a sovereign power. Bitcoin, by design, is not backed by any country. This divergence has the potential to open the door for creative defense attorneys.

**Fifth Amendment: A Viable Defense?**

Since cryptocurrencies have no centralized or regulatory authority, law enforcement face unique challenges in their investigative efforts and are commonly thwarted by serious impediments to obtaining transaction records as there is no financial intermediary to serve and process subpoenas or warrants. While the public blockchain is always accessible to law enforcement without the necessity of probable cause to search or issue a subpoena, the only information recorded on the blockchain is the public key, not the private one containing personal identifying information.

The inherent structure of Bitcoin makes investigation difficult both in terms of tracking the criminal activity and in seizing the assets. The essential transaction records displaying evidence of criminal activity are stored within encrypted digital wallets outside the reach of the government. To access the information in the wallets, the government must issue a subpoena compelling the owner to turn over either his or her private key or a decrypted version of the wallet. However, compelling an individual to disclose his or her private key raises serious self-incrimination concerns.

The Fifth Amendment provides that “[n]o person…shall be compelled in any criminal case to be a witness against himself.” However, this protection is not absolute; it only “protects a person…against being incriminated by his own compelled testimonial communications.”

For evidence to be testimonial in nature, and in turn implicate the self-incrimination clause of the Fifth Amendment, there must be an “attempt to force [an accused]’to disclose the contents of his own mind.”

The specific self-incrimination implications for compelled disclosure of private keys to decrypt bitcoin wallets have yet to be addressed by the courts; nonetheless, apt parallels may be drawn with cases in which defendants have been compelled to divulge their decryption keys to their hard drives and/or computer files. Whether the Fifth Amendment may be triggered in these decryption cases is a fact-heavy analysis turning on whether the government is aware that the defendant has asserted ownership over the encrypted file.

**Boucher Case**

The first case to address this issue was *In re Grand Jury Subpoena to Sebastien Boucher* out of a Vermont district court in 2009. Boucher was stopped by U.S. Customs and Border Protection officers who consequently found child pornography on his laptop—to which Boucher readily admitted ownership. Upon seizing the laptop, the government was unable to copy the hard drive containing the pornographic images because it was encrypted. When the government served Boucher with a subpoena to provide the decryption password, he moved to quash the basis that production would violate his Fifth Amendment rights against self-incrimination.

The Vermont district court applied the foregone conclusion doctrine and determined that compliance with the subpoena
did not constitute compelled testimonial communication. Because Boucher had previously admitted ownership over the files to law enforcement, their existence and location were already known to the government. Therefore, the incriminating information was a foregone conclusion and the divulging of the password was not testimonial in nature.

A year later, a Colorado district court made the same finding in United States v. Fricosu. After the government seized an encrypted computer pursuant to a search warrant, the subject of the investigation made a phone call to her incarcerated ex-husband during which she admitted ownership of the computer and knowledge of the password. The phone call was lawfully recorded by the prison facility and later discovered by the government. The court held that the existence of evidence, therefore, was again a foregone conclusion and thus not enough to trigger Fifth Amendment protection.

The Fricosu court, however, made clear that it was not ruling that there would never be a Fifth Amendment privilege against compelled disclosure of a password. Rather, the court indicated there are specific circumstances in which the government is already apprised of the suspect’s ownership (in many cases because of the subject’s own proactive assertion).

The most recent case on compelled decryption comes out of a 2012 Eleventh Circuit decision and illustrates a set of facts in which the Fifth Amendment may properly be invoked. While investigating John Doe for child pornography, the FBI seized his electronic devices, most of which contained encrypted files. The court ultimately upheld John Doe’s argument that compelled disclosure would violate his right against self-incrimination because “by decrypting the contents, he would be testifying that he, as opposed to some other person, placed the contents on the hard drive, encrypted the contents, and could retrieve and examine them whenever he wished.”

The court found the decryption and production to be testimonial in nature and, given the facts of the case, the government was not already aware of the files’ ownership and was thus unable to prove such evidence was a foregone conclusion.

The Eleventh Circuit employed a two-step analysis in reaching its conclusion: 1) determine if what the government seeks to compel is testimonial in nature, and then 2) determine whether the purported testimony is a foregone conclusion. When looking at the first prong, the court found that decryption and production were testimonial in nature because it was “tantamount to...his knowledge of the existence and location of potentially incriminating files; of his possession, control, and access to the encrypted portions of the drives; and of his capability to decrypt the files.”

In deciding whether the testimony was a foregone conclusion under prong two, the court developed two mechanisms in which the doctrine applies. The first consists in looking at the record as a whole to determine whether there is any indication that the government had knowledge as to the ownership of the existing files on the hard drive. In the second, without the government’s knowledge of ownership, “the location, existence, and authenticity of the purported evidence [must be] known with reasonable particularity, [otherwise] the contents of the individual’s mind [cannot be] used against him” in violation of the Fifth Amendment privilege.

The court ultimately found that John Doe’s testimony was not a foregone conclusion because the government was unable to demonstrate either knowledge of ownership or knowledge of the contents of the drives described with reasonable particularity, and, therefore, the protections afforded under the Fifth Amendment were viable.

It is inevitable that the government will seek to employ its subpoena power in future Bitcoin money laundering cases to compel the divulgence of private keys or decryption of digital wallets. While this is largely a fact-based analysis—in the inherent anonymity of Bitcoin—the strongest defenses may lie in challenging the government’s lack of knowledge over ownership of the digital wallet and/or knowledge of the illicit transactions described with reasonable particularity. Without either, the foregone conclusion doctrine is inoperable, allowing suspected individuals to avail themselves of the protections afforded under the Fifth Amendment’s self-incrimination clause.

**Government’s Tried and True Approach**

Despite the unique challenges of catching and prosecuting dark web vendors and unlicensed money transmitters in the modern technological era, the government has nonetheless been largely successful in its reliance on old-fashioned police techniques. Because the vendors operating on the dark web marketplaces heavily encrypt their activities, these sites and their vendors’ activities are nearly impossible for law enforcement to crack. Rather, law enforcement have had to rely upon old-fashioned, low-tech investigatory tools to infiltrate these criminal enterprises. Instead of being able to access the vendor’s administrator dashboard to expose the internal operations and transaction history, law enforcement may attempt to track the physical packages containing illicit items by noting distinguishing features and/or unusual quantities of packages being shipped by a single individual or group of individuals.

Further techniques can include the cultivation of confidential informants (CIs) and cooperating witnesses as an entry point into the dark web enterprises. Cooperating witnesses are typically individuals with criminal exposure but minimal culpability with the respect to the larger scheme who can provide valuable insights into the functioning of the operation in exchange for leniency on a criminal sentence or no sentence at all.

Over time, some of these cooperating witnesses may also become CIs who operate on an undercover level while still perceptively maintaining their role in the larger criminal scheme. This is particularly effective with unlicensed money transmitters who, while criminally culpable, are viewed as less of a threat to society than the individuals running the illicit operations on the dark web. The unlicensed money transmitter can identify the individual with whom the exchange is being made and verify the deposit of bitcoin into his or her wallet, thus tying the particular vendor to a particular wallet. This provides the government with the ability to achieve two crucial investigative goals.

First, the unlicensed money transmitter may permit law enforcement to access his or her wallet, thereby showing the deposit of bitcoin into the wallet from a particular public key, which can then be traced back on the blockchain to show its source. This public key can be further used to identify prior transactions on the blockchain conducted by the same user. However, it should be noted that law enforcement’s ability to trace these transactions on the blockchain may be hindered by the use of tumblers, thereby calling into question the government’s ready assertion of its ability to do so.

The government is limited to the dark web vendor’s bitcoin wallet that was used in a particular transaction with the CI. Given the fact that these vendors make every effort to obscure their activities, the bitcoin wallet the government is able to directly tie to them may be representative of only a small fraction of the wallets used by the dark web vendor. This severely cripples the government’s ability to track and trace the full picture of the criminal proceeds, thereby limiting the government’s charging ability.

Additionally, it is possible that once
the government becomes aware of the vendor’s asserted ownership over a particular wallet, the government may then potentially be able to subpoena the vendor’s decryption or private key, thereby circumventing the vendor’s claim to Fifth Amendment protection.

While the inherent anonymity, use of tumblers, the inconsistancy in regulatory definitions of the currency, the failure of Congress to step into today, and a host of other impediments, stand in the way of toppling dark web marketplaces that exist beyond the government’s pale, the government has been able to compensate through the use of proven investigative techniques. Thus, essentially, the dark web marketplace and its vendors are nothing more than a modern criminal drug enterprise.

3. Id.
5. Id.
8. Id.
9. Id.
10. Bitcoin is both a currency and a protocol. Throughout this article, the term “bitcoin,” lower case, refers to the virtual currency that is digitally traded between users. “Bitcoin,” when capitalized, refers to both the open source software used to create the virtual currency and the peer-to-peer network formed as a result.
13. DHS REPORT 2014, supra note 11, at xi. Alcock is the collective name for cryptocurrencies offered as alternatives to Bitcoin. The current market cap for cryptocurrencies is over half a trillion dollars.
14. FATF REPORT 2014, supra note 11, at 5.
17. DHS REPORT 2014, supra note 11, at xi-xiii. Bitcoin miners are compensated with newly created bitcoin by verifying each transaction on the blockchain. Id. at xiii.
The Addicted Lawyer: Tales of the Bar, Booze, Blow, and Redemption and Girl Walks Out of a Bar: A Memoir

Peter was a well-regarded patent attorney in the Silicon Valley. He died a drug addict. His last cell phone call was not to his ex-wife or his kids but dialing into a conference call. Anyone you know?

Whether one is an associate or a senior partner in “biglaw” or has cycled through a number of different lawyer jobs, substance abuse is not surprising among professionals who are paid to be hostile. That character trait—positive or negative—leads some lawyers to feel that they are square pegs in round holes, which can lead to substance abuse. It is reported that “40 to 70 percent of all disciplinary proceedings and malpractice actions involve substance abuse,” be it alcohol and/or drugs, acknowledged or denied.

Two books, The Addicted Lawyer: Tales of the Bar, Booze, Blow, and Redemption by Brian Cuban and Girl Walks Out of a Bar: A Memoir by Lisa F. Smith, come at the substance abuse issue in our profession from equally harrowing experiences. While Cuban bounced around professionally, Smith had a career in biglaw. Both share similar experiences, from lawyer to substance abuser and the long road back in recovery. Already drinking in college, the authors got themselves through law school—Cuban at University of Pittsburgh and Smith at Rutgers. She landed a job as an associate in biglaw doing securities work; Cuban passed the Pennsylvania Bar and then moved to Texas to be near his brothers, one of whom is Mark Cuban, owner of the Dallas Mavericks and one of the investors on the TV program Shark Tank.

The books tell very personal stories. In addition to telling his story in unflinching terms, Cuban interviews attorneys in recovery, lawyers who defend other lawyers on ethics charges arising from substance abuse issues, and substance abuse experts. He describes how difficult it was to finally come to terms with his own substance abuse issues and the havoc they wreaked on his life, as he bounced back and forth, trying to quit without success.

Cuban finally went to a recovery meeting at the urging of his therapist, but it took him years to get to that point, failing more than once in an effort to regain his sobriety. More than one divorce, depression, thoughts of suicide, and feelings of unworthiness were as much a part of Cuban’s life as the booze and coke. It was a vicious cycle, the latter feeding the former and vice versa. For Cuban, recovery was about facing his fears, the fear of having to be authentically himself, the fear of failure (e.g. relapse and rejection if he did so), the fear of letting down people he loved and cared about, the fear of professional consequences, the fear of being alone in his sobriety.

Smith’s story, appropriately subtitled A Memoir, is just as personal: days and nights of binge drinking, snorting coke, and going into work loaded on one substance or the other, or both. It is not a pretty picture but one that is brutally honest. Smith is unsparring in describing her descent to the bottom and the difficult road crawling back up. Her life had to change. It was finally recognizing her problem and checking herself into a locked detox facility in New York City where she lived and practiced. She realized that she could no longer deny her addictions.

As Smith tells it, “there was no inciting event that led me to pull the alarm on my life” (p. 184). No drunken accident, no professional humiliations, no family explosion, “no blackout followed by waking up next to a stranger” (id.). Maybe, she muses, it was her unconscious telling her that she was killing herself if she didn’t stop the booze and the cocaine. “Why” became unimportant. When she made the decision to go to a detox facility, she thought she was packing for a spa rehab “…where Robert Downey, Jr. would give me a sponge bath and Ben Affleck would wrap me in a warm towel” (p. 201).

Withdrawal was nothing like Smith had seen in the movies. Instead, it was painful—physically and mentally—accompanied by an unending longing for a drink. At a required recovery meeting, she heard the speaker tell her and the others that they had bought a one-way ticket to self-destruction if they didn’t clean up their acts. Without the denial booze and drugs afforded her, Smith realized that this guy was on a path to self-destruction if they didn’t clean up their acts. Without the denial booze and drugs afforded her, Smith realized that this guy was on a path to self-destruction if they didn’t clean up their acts. Without the denial booze and drugs afforded her, Smith realized that this guy was on a path to self-destruction if they didn’t clean up their acts.

Smith had self-medicated her anxiety and depression to the point of numbness. She had no idea what life would be like on the other side of that. Recognizing that she was an addict regardless of substance, Smith learned the only way for her to recover was to lay off the drugs and booze forever and to go to recovery meetings. However, she eventually realized that it was not about if she was staying sober, it had become a story about how. Sober now for more than a decade—for more than 4,000 mornings—Smith has decided that “just for today, I will not drink” (p. 277).

Lawyers tend to see asking for help as a sign of weakness, an inability to manage one’s life and problems without intervention. Asking for help, Cuban says, is being vulnerable, and lawyers are paid to be invulnerable. Cuban and Smith say their fear of being found out surpassed the need to confront their addictions. As the books indicate, they were high-functioning addicts who binge-drunk all the way to blackouts, snorted coke wherever and whenever—including in their offices—and let everything and everyone fall by the wayside in the grips of those addictions.

Like other professions, law has a code of silence about colleagues

Jill Switzer is a mediator with Alternative Resolution Centers.
who appear to be in the throes of substance abuse. The ranks close, and all hope the problem will go away. Reputational risk draws us up short.

We don’t see the issue beyond the individual, but the grasp of substance abuse is far beyond that. How is substance abuse affecting the practice? The clients? The firm? Interaction with opposing counsel and the court? Family and friends? And not necessarily in that order.

Do we have an obligation to our colleagues, to our profession, to our clients to speak up when we see substance abuse, i.e., “if you see something, say something”? The problem that both authors discuss at length is the problem of denial. No one wants to admit that everything can’t be handled perfectly. After all, we’re lawyers, right? And since we’re supposed to be able to resolve our clients’ problems, we should be able to solve our own without assistance, right?

A 2016 ABA study concluded that “…attorneys experience problematic drinking that is hazardous, harmful, or otherwise generally consistent with alcohol use disorders at a rate much higher than other populations.” The study also concludes that being in the early stages of practicing law is “…strongly correlated with a high risk of developing an alcohol use disorder.”

The gladiatorial nature of practicing law precludes lawyers from turning to each other or a third party in times of need. The fear of being found out is paramount. Our first mistake, Cuban says, is not seeking help.

What is most revealing about the two books is the realization that neither Cuban nor Smith liked being lawyers. (Sound familiar?) They rewrote the narratives and switched to careers more congruent with their personalities. That’s not surprising. Becoming a lawyer is often a fallback position; it allows people to stall for three years (while incurring huge amounts of debt) about career decisions. Once practicing, many lawyers ask themselves, “I went to law school for this?”

That kind of unhappiness, stress, depression, and anxiety can lead to the sorts of substance abuse problems that Cuban and Smith describe as well as their struggles to surmount them. They are very brave in sharing their experiences. They saved their own lives and perhaps reading one or both books will help save others.

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4 Id.
How LACBA’S Judicial Elections Evaluation Committee Works

**EVERY TWO YEARS, VOTERS ACROSS CALIFORNIA** are asked not only to select candidates for statewide offices and city council seats but also to serve as superior court judges. While high-profile offices and propositions typically generate millions of dollars in TV, radio, and billboard advertising, almost nothing is known about, and little information is available for, the candidates for judicial office.

The Judicial Elections Evaluation Committee (JEEC) of the Los Angeles County Bar Association fills the information void. The JEEC gathers information about all candidates for each open and contested bench seat in Los Angeles County. This includes sitting judges who are challenged at the end of their six-year term and seats left open due to retirement, disability, or death. (Sitting judges, whether elected or appointed by the governor, who are not challenged at the end of a term are automatically reappointed for another six-year term.)

For the 2018 election, there were 28 candidates vying for 11 seats, including one sitting judge who was challenged. As soon as the candidates filed papers indicating their intent to run, the JEEC provided them with lengthy questionnaires seeking detailed information about education and employment background, trial experience, and involvement in litigation, whether as trial counsel or a party. The questionnaires seek the same information required by the State Bar’s Commission on Judicial Nominees Evaluation, which provides guidance to the governor in the judicial selection process. Candidates are also asked to submit 75 references, who are asked to complete questionnaires regarding a candidate’s judicial temperament, experience, reputation, bias, and work ethic.

The JEEC rates each candidate’s qualifications to serve as a superior court judge. Committee members start with the information provided by the candidates and their references but expand the investigation widely. Inquiries are made to colleagues, opposing counsel, and judges before whom candidates appear. Databases are searched to determine if material information, such as litigation in which the candidate was a party or a sanctions order against a candidate, was omitted from the questionnaire.

Each candidate is afforded the opportunity to be interviewed by one of the three JEEC subcommittees. Any negative information learned through the investigation is disclosed to the candidate prior to the interview, so the candidate can prepare for and address the concerns. If new negative information is learned after the interview, the candidate is invited to respond at a second interview. The subcommittee then votes on a proposed rating.

After the investigation is complete, the subcommittee reports its findings to the full committee, which then reviews each candidate’s qualifications, references, endorsements, and negative information. In a room with 30 attorneys, the discussions are often detailed, lengthy, and animated.

Ultimately, tentative ratings are awarded by vote. Most receive a Qualified rating, meaning that the committee believes the candidate “possesses professional ability, experience, competence, integrity and temperament indicative of fitness to perform the judicial function satisfactorily.”

Candidates who receive more than 60 percent of the vote can receive a Well Qualified rating, meaning they have the qualifications “indicative of superior fitness to perform the judicial function with a high degree of skill and effectiveness.”

More than 75 percent of committee members must agree before a candidate receives an Exceptionally Well Qualified rating, which means the candidate possesses qualifications “considered to be of remarkable or extraordinary superiority so that, without real doubt, the candidate is deemed fit to perform the judicial function with distinction.”

Each cycle, there are a handful of candidates who the committee believes lack one or more of the qualities required “to perform the judicial function satisfactorily.” While they may be excellent attorneys, if they do not receive more than 50 percent of the votes for one of the other categories, they will receive a Not Qualified rating. Reasons for the rating are detailed for these candidates.

Those who receive a tentative rating of Qualified or Not Qualified can appeal. These candidates appear before the full committee to explain what rating they believe they should have received and why. Following appeals and further discussions, the committee votes on final ratings. Once the final ratings are reviewed by LACBA’s Board of Trustees, they are published in a report and circulated widely.

The other primary source for information about local judicial candidates is the editorial page of the Los Angeles Times. Unlike the Times, though, the JEEC neither endorses candidates nor explains why one is comparatively better than another. The JEEC’s mission is limited to rating each candidate’s qualifications objectively. As a result, there are often races in which some or all candidates receive the same rating from the JEEC. Similarly, there have been races in which both candidates received Not Qualified ratings. Since the JEEC’s ratings are not comparative, any candidate’s tentative or final rating is not taken into account when rating another candidate.

While most LACBA committees meet year-round on a regular schedule, all of the JEEC’s work and meetings occur between mid-February and late April in even-numbered years. Despite the compressed schedule, each of the 30 volunteer JEEC members typically spends between 50 and 100 hours on investigations and committee work to ensure the ratings process is thorough and fair. The JEEC’s final report can be found at www.lacba.org/2018-jeec.

Jerry Abeles, a partner in the complex litigation department at Arent Fox LLP, has been chair of the Judicial Elections Evaluation Committee since 2014 and has been a committee member since 2004. He is also a member and past chair of the Los Angeles Lawyer Editorial Board.
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