THE BKCG BULLETIN

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BKCG

BURKHALTER KESSLER CLEMENT & GEORGE LLP

Breaking News: BKCG Gets Big Win For Ralphs In COVID-19 Class Action Lawsuit!

In a case in which the plaintiffs sought and received local and national media attention, the Los Angeles Superior Court agreed with BKCG lawyers and dismissed class action claims of employees of Ralphs's Compton distribution center, a major cog in the Southern California food supply. As an essential services business, the distribution center has remained open during the pandemic and received and implemented guidance from the CDC, Cal/OSHA and the Los Angeles Department of Public Health on preventing the spread of COVID-19 at the workplace.

Ralphs implemented protective measures and conducted contact tracing as guidance from the expert agencies evolved, but the agency guidance for Ralphs's business was not released until after almost 100 of the approximately 800 distribution center employees had already tested positive for COVID-19. Ralphs's protective measures and contact tracing quickly gained traction,

and there were only a handful of new positive tests in June. The rate of positive tests has slowed to a trickle, as only two employees have tested positive for COVID-19 since the beginning of August.

The facts did not stop a group of opportunistic employees – some of whom, ironically, are repeat violators of the social distancing and protective measures Ralphs adopted and posted in signs throughout its facility – from seeking a windfall disguised in a plea for justice and immediate action. In July, these employees sued Ralphs and sought injunctive relief under theories of public nuisance, declaratory relief, and unfair competition.

Before BKCG could challenge the lawsuit on Ralphs's behalf, the plaintiffs made an *ex parte* application for a temporary restraining order which asked the Court to be a watchdog over Ralphs's protective measures and safeguards. The Court denied their request based upon overwhelming evidence, assembled by a team of BKCG attorneys and Ralphs representatives on short notice, that Ralphs's safeguards were preventing the spread of COVID-19 at the distribution center. The plaintiffs subsequently abandoned their efforts to obtain pre-trial injunctive relief. (continued on page 6)

New Law Substantially Increases The Homestead Exemption

After plaintiffs prevail in a lawsuit, they usually receive a document issued by a judge called a "judgment", which essentially says the defendant owes the plaintiff (now referred to as a "judgment creditor") a certain amount of money. Of course, obtaining a judgment often does not result in the losing defendant (the "judgment debtor") simply writing a check to the judgment creditor for the amount owed. Instead, the judgment creditor often needs to take action to enforce that judgment.

One of the strategies that aggressive judgment creditors often employ to enforce judgments is to foreclose on a judgment debtor's real property, often his or her primary residence. However, the law in California protects a certain portion of the equity that a judgment debtor maintains in his personal residence through a law referred to as the "homestead exemption". Under California law, "'[t]he object of all homestead legislation is to provide a place for the family and its surviving members, where they may reside and enjoy the comforts of a home, freed from any anxiety that it may be taken from them against their will, either by reason of their own necessity or improvidence, or from the importunity of their creditors." *Thorsby v. Babcock* (1950) 36 Cal. 2d 202, 204. "[T]he homestead law is not designed to protect creditors, but protects the home against creditors . . . thereby preserving the home for the family." *Amin v. Khazindar* (2003) 112 Cal.App.4th 582, 588.

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In This Issue

Reopening Your Business In The Midst Of COVID-19

As many of you know, the State of California recently implemented a four-tiered system as part of the State's "Blueprint for a Safer Economy" (https://covid19.ca.gov/safer-economy/) that, based upon certain criteria, allows businesses county by county to start relaxing COVID-19 restrictions first implemented in March of this year. The four tiers are designated by color (purple, red, orange and yellow) and as new case numbers and COVID-19 test-positivity rates decrease, counties move to less restrictive tiers. As this movement occurs across the State, many businesses in various industries will be faced by the somewhat daunting task of figuring out how to best protect the health and safety of their employees. This article is, therefore, a broad attempt at introducing our clients to certain tools that can guide reopening decisions as well as an introduction to basic employment issues that are, almost certain, to arise.

Probably the premier resource made publicly available regarding reopening is the "COVID-19 Employer Playbook for a Safe Reopening" (the "Playbook") published by the California Department of Public Health ("CDPH"). It can be accessed at the following website address and is updated frequently. https"//files.covid19.ca.gov/pdf/employer-playbook-for-safe-reopening-en.pdf

The Playbook warns that reopening is going to vary industry by industry and county by county and it provides helpful links so that a business can design a reopening plan specific to its needs and potential risks. As the Playbook provides, the State requires as a first step before any business may reopen that the business "1. Perform a detailed risk assessment and create a work-site specific COVID-19 prevention plan; 2. Train workers on how to limit the spread of COVID-19; 3. Set up individual control measures and screenings; 4. Put disinfectant protocols in place; 5. Establish physical distancing guidelines; [and] 6. Establish universal face covering requirements (with allowed exceptions) in accordance with CDPH guidelines."

The Playbook stresses, however, that taking those six steps listed above is just the start. For example, the Playbook addresses other important issues, such as what to do if an employee feels symptomatic or tests positive. The Playbook also reminds California businesses of various legal obligations such as a reporting requirement to the local health department in the event of an outbreak (defined as a "non-health or non-residential congregate setting workplace" that experiences three or more laboratory-confirmed cases of COVID-19 within a two-week period among employees who live in different households). To sum up, each business in California should become familiar with the Playbook and use it as an essential reopening resource.

In conjunction with the Playbook, businesses should discuss employment issues with their legal counsel that are also likely to occur as they reopen. For example, not having an adequately safe work environment can expose a business to liability so review your reopening plan with counsel.

In addition, managers in charge of human resources should be ready to address the unique employee discipline issues resulting from COVID-19. For instance, the State requires businesses establish universal face covering requirements. Should an employee (or, in fact, a visitor to a workplace) refuse to abide by that requirement, that business is exposed to liability. As a result, what is required of employees should be clearly expressed by human resources and deviations from those requirements must result in discipline. Businesses should consult with counsel to communicate and implement these "new rules" resulting from COVID-19 and State and local laws.

Additionally, it is likely that owners and managers may meet with reluctance from some employees scared to return to the workplace. Businesses should consult with counsel regarding the response to such a situation. For instance, California's Labor and Workforce Development Agency ("LWDA") website provides robust advice to both employers and employees regarding their respective rights and obligations upon returning to work. The LWDA advises that non-essential workers who are improperly terminated for refusing to return to a workplace may have a retaliation claim. It is easy to imagine a scenario where an employee claims to be immunocompromised and expresses concern about returning to the workplace. In fact, the LWDA website points out that the CDPH "has issued public health guidance urging individuals who are over 65, immunocompromised, or have certain serious health conditions … to stay home." The LWDA urges in no uncertain terms that businesses accommodate these individuals as much as possible. As a result, prior to making decisions that impact an employee expressing anxiety about returning to work, businesses should consult with counsel.

As you can see from just the few broad issues outlined above, the challenges COVID-19 presents to businesses in this state are vast and varied and failing to properly respond to these challenges as businesses reopen could have significant legal consequences. Therefore, do not hesitate to reach out to counsel as you come up with a reopening plan for your business. This is unchartered territory, so exercising caution is the best approach.

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Should I Form My New Business Entity Outside California?

As a business lawyer, this is a question I get asked a lot by my clients, almost all of whom are operating, or plan to operate, a business, here in California. While the answer to this question is, of course, dependent on the specifics of the business that the new entity will conduct or is conducting, there are some principles of general applicability. There are also a few common myths on this subject which need to be dispelled.

1. If your entity is "transacting intrastate business" in California, it must be qualified to do business here, irrespective of where it is incorporated. Many business owners are led to believe that, because Delaware is rightly considered, to have the most sophisticated set of corporate laws in the United States, they should form their new entity there. It is also true that Delaware has a dedicated business law court, the Delaware Court of Chancery, which, to quote the Delaware Courts website, "is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of…Delaware corporations and other business entities." Similarly, other people decide to form their entities in Nevada, for example, because Nevada has no state income tax, or in Wyoming, because they have heard that Wyoming entities afford greater privacy about entity ownership[1]. However, the practical realities are rather more complicated than that. What many people fail to understand is the fact that if an entity is "transacting intrastate business" in California[2], the entity must register with the California Secretary of State and obtain a "Certificate of Qualification" under Corporations Code § 2105.

This process, whilst straightforward, involves appointing an agent for service in California and providing an annual list of either statutory officers for a corporation or, for a limited liability company, a bi-annual list of at least one manager (or a member, if the LLC is member-managed). Thus, any apparent advantage of total anonymity that might be obtained by incorporating outside California disappears as soon as the entity registers to do business as a foreign entity in California. California registration also brings with it the obligation to file annual state tax returns for the entity in California and for the entity or its owners (depending on the entity's tax treatment) to pay California income tax on income deemed earned in California. Bear in mind that the entity will have similar obligations plus, typically, an annual registration or franchise tax-type fee, and thus a duplication of expense in the state of incorporation, whether it is actually transacting business there or not. Nevada, for example, charges an annual fee (for filing an annual report plus a business license fee) of $650 per calendar year. In addition, California residents who are equityholders in a non-California entity cannot escape California income tax liability simply because the entity is not incorporated in California.

One of the penalties of not obtaining a Certificate of Qualification when one is required is an entity's inability to prosecute or defend a lawsuit in California until the Certificate is obtained, which is obviously not a good thing. It should also be mentioned that an entity's jurisdiction of formation may, practically speaking, have little or no impact on the ability of the entity's judgment creditors to seize assets of the entity located in a state in which the creditor has a judgment, for example, by garnishment or foreclosure. Judgment enforcement laws apply in the state in which the judgment debtor's assets are physically located, and not where the entity is incorporated.

2. California corporate law may apply to a foreign corporation that conducts more than half of its business in California. In the past, several clients have told me that they wanted to incorporate outside California so that, for example, they could avoid certain aspects of California corporate law that would be inconvenient to them, such as the "corporate opportunity doctrine", which forbids corporate fiduciaries from appropriating new business prospects for themselves without first offering them to the company. Unfortunately, one of California's so-called long-arm statutes, Section 2115 of the California Corporations Code, subjects foreign corporations to California corporate law on a large number of issues, if they conduct more than half of their business in California, based on an averaging of three criteria, namely property, payroll, and sales; or if more than half of their outstanding voting securities are held by persons with a California address. The areas of California corporate law that will apply (as far as any corporate legal dispute brought in California court is concerned), rather than the laws of the entity's state of incorporation, include such things as removal of directors, filling of director vacancies where less than a majority in office elected by shareholders, directors' standard of care, indemnification of directors and officers, and supermajority vote requirement and limitations on sale of assets. Thus, as just described, forming a corporation outside California in an attempt to benefit from more favorable corporate laws elsewhere may well be futile if the corporation transacts the majority of its business in (or from) California.

3. For commercial real estate ownership, consider incorporating where the property is located. Generally speaking, the rental of real property, whether a single-family residence, apartment building or commercial property, is considered engaging in intrastate business in the state where the property is located, requiring the owner entity (usually an LLC) to register to do business, report income and to file tax returns in that state. For that reason alone, it makes sense to first consider forming the LLC in that state, unless there are compelling reasons not to do so. For non-California residents in particular, due to the aggressiveness of California's Franchise Tax Board, it makes sense not to utilize a California LLC to own commercial real estate located outside California but, at a minimum, California residents will avoid duplication of entity expense and red tape by using a non-California entity to hold title to real property located outside California.

4. Very often, the theoretical advantages of incorporating outside California are outweighed by the practical disadvantages. There can be no question that, for certain entities and in certain industries and circumstances, incorporating outside California, especially in Delaware, may be desirable, even if the company is based in California. For example, many venture capital firms and angel investors prefer that startups incorporate in Delaware, and investment bankers may advise incorporation (or reincorporation) in Delaware for companies that intend to go public. However, in my experience working with hundreds of California-based small to mid-size companies, the touted advantages of being incorporated outside California were either nonexistent or illusory. In many cases, the inconvenience and expense of having to file multiple state tax returns, appoint multiple agents for service and even seek legal advice from corporate lawyers qualified to practice law in their entity's state of incorporation (as happened to a client recently whose corporation was incorporated in Wyoming), etc. actually made our client regret having formed an entity outside California. If your entity has a relatively small number of shareholders or members all of whom reside in California, and is not intending to go public, the sophisticated corporate laws and courts of Delaware may simply never be of any applicability to you.

1.California does not require entities to disclose the identities of its owners in a publicly available document, except that if an LLC is member managed LLC, the bi-annual Statement of Information requires the name and address of least one member-manager to be listed.

2. Meaning, for example, that the entity has a physical location, employs people, or regularly engages in business transactions in California, including engaging in a large volume of internet sales with California residents.

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Protecting Your Trademark In Online Marketplaces During The COVID-19 Pandemic

COVID-19 continues to fundamentally transform our economy and the way we do business with no end yet in sight. The pandemic has caused once-thriving industries to founder, forcing many businesses and individuals to seek new sources of revenue. Purchasing habits are also shifting as consumers seek to shop from the safety of their homes more than ever. As a result, experts forecast that this year will be the biggest ever in terms of online sales. However, trademark infringement disputes are on the rise as unscrupulous proprietors are already trying to exploit these chaotic market conditions. This article discusses the legal methods that businesses can use in order to shield their trademarked goods in these exceedingly uncertain times, particularly through the use of the material difference exception to the first sale doctrine.

The first sale doctrine in trademark law allows the holder of a trademark to control the terms of only the first sale of the trademarked product. Under the first sale doctrine, the trademarked product may then be re-sold in the market without violating the trademark. This means that the trademark holder largely loses control over its products after the first sale. In addition, anyone in the market thereafter who obtains a product initially sold with a warranty may seek to enforce the terms of that warranty against the initial seller who provided the warranty (given that the product has not been materially modified), creating significant risk for the trademark holder.

However, the material difference exception renders the first sale doctrine inapplicable to goods which feature a "material difference" from the trademarked goods. A "material difference" is anything that a consumer would find relevant when considering to purchase a product. One method for a trademark holder to take advantage of this exception is to designate certain "authorized re-sellers" for its goods who are allowed to re-sell the trademarked goods with accompanying warranties which the trademark holder will honor.

By designating authorized re-sellers, a trademark holder can disclaim and avoid liability for warranties provided by unauthorized re-sellers. A product purchased from an authorized re-seller who offers a valid warranty is "materially different" from a similar product purchased from an unauthorized re-seller who does not offer a valid warranty because the addition of a warranty would be relevant to any consumer considering whether or not to purchase the product, and thus the first sale doctrine does not apply to products sold by unauthorized re-sellers. This not only allows a trademark holder to control its trademarked products and accompanying warranties after they enter the market, but it also allows the trademark holder to take enforcement action against any trademark infringers.

Many businesses benefit enormously by availing themselves of the material difference exception to the first sale doctrine due to the control it grants businesses over their products after they enter the distribution chain. As a practical matter, the material difference exception allows for enforcement of trademark in an online marketplace by way of the platform's "takedown notice" procedures. For example, should a seller offer trademark-infringing goods for sale on Amazon–the largest online marketplace–the trademark holder may submit a takedown notice to Amazon, notifying Amazon of the infringement and seeking removal of the infringing goods from the platform. In cases where the online marketplace (such as Amazon) takes the goods down, and the offending seller recognizes that it has infringed upon a valid trademark, a takedown notice can resolve the issue quickly and favorably for the trademark holder without further dispute.

However, this strategy inherently comes with some degree of risk. Even if a trademark holder obviously operates within the ambit of the material difference exception to the first sale doctrine, aggressive competitors may still attempt to challenge these takedown orders. Such competitors sometimes file a type of defamation suit known as a "SLAPP" lawsuit ("SLAPP" stands for "Strategic Lawsuit Against Public Participation) against the trademark holder who filed the takedown notice on the grounds that the trademark holder's allegations of trademark infringement were defamatory. In these situations, filing what is known as an "anti-SLAPP" motion in response to such a lawsuit often proves successful in winning dismissal for the defendant trademark holder. A dismissal of the SLAPP lawsuit effectively upholds the takedown notice, thereby protecting the trademarked goods in dispute.

Businesses selling trademarked goods, especially those sold online, should prepare now for the obstacles that are bound to arise in the coming months. If your business needs advice regarding protecting trademarks or regarding trademark disputes, BKCG's experienced attorneys can assist with any issues your business faces.

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Should I Form My New Business Entity Outside California? (continued from page 3)

5. Reincorporating a non-California entity in California is a possibility. If you have formed a non-California entity and wish you had not, assistance may be at hand, California does permit foreign business entities to convert into a California entity such as a corporation or an LLC, provided that the conversion is permitted under the laws of the jurisdiction of the foreign business entity. This is a pretty quick, easy and inexpensive process and BKCG has assisted a number of clients with such conversions. The converted company retains its Employer Identification Number, and new California entity documents are prepared for the converted entity. Unsurprisingly though, California entities are not permitted to convert to a foreign entity. Please note, that this article is intended to be general in nature and should not be interpreted as legal advice applicable to your entity. Ultimately, a decision on where to incorporate a new entity may be driven by such factors as tax issues; an intention to relocate the business and/or its owners outside California; the non-California residence of co-owners; the non-California source of entity income; or complex asset protections considerations, all of which are beyond the scope of this article. As always, you should seek advice based on your particular situation before making this or any other legal decision.

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Recent Court Decisions On COVID-19 Business Interruption Claims

Since March, there have been a large number of lawsuits filed by businesses against their property insurance carriers seeking business interruption coverage for losses due to closures caused by COVID-19 and government related shut-down orders. The initial issue Courts are grappling with is whether the virus that causes COVID-19 constitutes "direct physical loss or physical damage" to property – a requirement in most all property insurance policies to trigger coverage.

To date, there have been four cases nationally where Judges have rejected attempts by insurers to dismiss COVID-19 business interruption lawsuits. Three of the cases are in the Western District of Missouri with a fourth case in New Jersey. Overseas, Courts in London and France have also begun to address the issue and have come down in favor of coverage.

One of the recent cases in Missouri concerns several dental offices that were forced to close or reduce operations in response to government orders issued to stem the spread of COVID-19. *(Blue Springs Dental Care LLC et al v. Owners Insurance Co.,* 4:20-cv-00383 (W.D. MO.) The dental offices argued that there was a strong possibility that employees and others who worked in the office had brought the virus into the premises. Operations had to be suspended to prevent the spread of the virus which, in turn, effectively deprived them from using their offices. In reviewing the complaint, the Court held that the dental offices sufficiently pled a claim for coverage as the virus satisfied the "physical loss or physical damage" requirement for purposes of a motion to dismiss. Consequently, the case was allowed to proceed past the motion to dismiss stage.

This decision followed another Federal Court decision in Missouri that came to the same conclusion. In *Studio 417, Inc., et al v. The Cincinnati Ins. Co.* (20-cv-03127), the District Court denied the insurer's motion to dismiss. The insurer argued that there must be "tangible or structural damage to property" like with storm damage to trigger coverage. The Court rejected this argument. In its holding, the Court stated that the coverage trigger is physical loss or damage and that it "must give meaning to both terms" (i.e., physical loss / inability to physically use the property or physical damage / alteration of the property). To adopt the insurer's position would conflate physical loss with physical damage. The lawsuit brought by the Studio 417 hair salon was allowed to proceed. See also *KC Hopps v. Cincinnati Ins. Co.* (4:20-cv-00437 W.D. M.O.); *Optical Services USA/JCI v. Franklin Mutual Insurance Co.* (No. BER-L-3681-20) (where a N.J. Court rejected an insurer's attempt to dismiss an optical services company's lawsuit holding that physical loss is different than physical damage).

Across the pond, London judges took a much more favorable view toward finding coverage for businesses. Courts recently ruled that insurers were wrong to reject tens of thousands of claims from small businesses. And a French Court similarly found in favor of a restaurant that was forced to close due to COVID-19. We are still in the early stage of the fight. While insurers prevailed in many of the early cases, recent decisions have halted the trend. Given that there are hundreds of lawsuits filed by businesses against insurers, it remains to be seen how other courts will address this key issue of "physical loss or physical damage". And, of course, until Appellate Courts begin to weigh in on the issue, there will only be uncertainty.

Although it will take some time before we see any finality on the issue, you should be aware that in many instances, your business insurance policy requires that a lawsuit be filed against the insurer within 1 year from the date of the occurrence (i.e., the shutdown caused by COVID-19 and/or the government closure orders.) To that end, you should be aware that you may need to make a decision on whether to pursue litigation before the Appellate Courts issue their opinions. If your business has been closed due to COVID-19 or a government shut down order, you should contact us to discuss your coverages and your options.

Please contact Keith Butler at kbutler@bkcglaw.com or call (949) 975-7500 if you have any questions about any issue discussed in this article, or any other related matter.

Breaking News: BKCG Gets Big Win For Ralphs In COVID-19 Class Action Lawsuit! (continued from page 1)

After the plaintiffs filed an amended complaint, BKCG filed a demurrer asking the Court to dismiss the claims seeking injunctive relief under the theory of judicial abstention, which states that a court may refuse to take a case that seeks equitable relief if granted that relief would require the court to assume, or interfere with, the functions of an administrative agency. The trial court agreed with BKCG and held that it would be required "to determine and then to impose a certain standard for, say, the number of masks that must be provided to each employee, when a 'high touch' surface has been adequately disinfected, or when an employer has provided 'proper postings.'"

The court recognized that it "would likely be called upon to create guidelines for how a distribution center should be properly run during a global pandemic" and that its efforts could "improperly interfere with the functions of administrative agencies like Cal/OSHA and the Los Angeles Department of Public Health." The trial court also took judicial notice of communications between Ralphs and these public agencies which demonstrated that the agencies had exercised their jurisdictional authority to investigate the conditions at the distribution center. Notably, none of the agencies cited Ralphs for violation of any prevailing guidance or instruction, and Cal/OSHA issued a "Notice of No Violation After Inspection" on July 2, 2020.

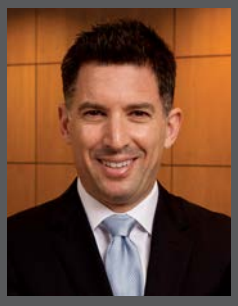
After the Court's ruling, the lawsuit that remains looks nothing like the one that plaintiffs rushed to court with in July amidst a media blitz and a flurry of press releases. With all of their equitable claims for injunctive relief having been dismissed *without leave to amend*, plaintiffs have only the alleged compensatory damages of the girlfriend of one of the former plaintiff employees, who claims that she contracted COVID-19 from him and can only recover under a tenuous public nuisance theory, and a vaguely alleged claim that Ralphs's attendance policy gives employees the "feeling" that they have to report to work even if they felt sick, even though the policy and literally dozens of signs throughout the distribution center expressly state the opposite. These claims are subject to further challenges at the pleadings stage, and BKCG will continue to push for their elimination. Regardless of their eventual outcome, the plaintiffs' effort to strong-arm Ralphs with the threatened closure of this critical distribution center was, itself, shut down by the court.

Please contact Daniel Kessler or Michael Oberbeck at dkessler@bkcglaw.com and moberbeck@bkcglaw.com or call (949) 975-7500 if you have any questions regarding COVID related claims against your business.

New Law Substantially Increases The Homestead Exemption (continued from page 1)

Until September 15, 2020, the homestead exemption in California was $75,000 if the judgment debtor was single without dependents, $100,000 if they were married or head of household, and $175,000 if they were disabled or over the age of 65. These homestead exemption amounts had remain unchanged for several years despite the substantial amount of appreciation that California real estate has enjoyed through the years. As a result, the homestead exemption provided ever diminishing protection to judgment debtors, as the following example demonstrates: if a single judgment debtor without dependents had $1 million in equity in his home and a judgment creditor maintained a $900,000 judgment against him, that judgment creditor could foreclose, force the sale of the judgment debtor's residence and receive $900,000 from the proceeds of that sale, resulting in the judgment debtor only receiving $100,000 as his homestead exemption.

However, on September 15, 2020, Governor Newsom signed into law AB1885, which changed California's homestead exemption dramatically. Now, the California homestead exemption increased from a minimum of $75,000 to at least $300,000, and it is even higher in counties with higher median home values because the homestead exemption is the greater of $300,000 or the countywide median sale price of a single-family home, not to exceed $600,000. To ensure these exemption amounts do not become too small again as home prices continue to rise over time, the new law ensures these amounts will adjust annually for inflation. Because the median price for a home in Orange County greatly exceeds $600,000, the homestead exemption in Orange County will now be $600,000 (or eight times greater than it had been for a single judgment debtor with no dependents).



Of course, whether this change in the law is a positive or negative will depend on whether you are the judgment creditor or the judgment debtor. In either case however, the change in the law is significant and will likely change how litigants evaluate lawsuits and whether the prevailing party will be able to collect on a judgment.

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