Digital Fruit: Legal updates in Food, Beverages & AgTech

ROYSE LAW

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Editor's Welcome

The Royse Law Firm is widely known as the sponsor of the annual Silicon Valley AgTech Conference. To enhance the firm's services to the food system community, we provide you with this legal newsletter, which is published quarterly. As you'll see below, topics that merit thoughtful explanation appear first. They are followed by Short Takes, which feature brief descriptions of legal news. We'd like to thank Erica Riel-Carden, who is in the Royse Law Legal Incubator, for her assistance in editing the Short Takes

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section.

Thanks, and welcome again.

Alan J. Haus, contact me

Short Takes

EMPLOYMENT LAW ISSUES IN FOOD, BEVERAGES & AgTECH

By Lisa Chapman

Employers must comply with both Federal and state employment laws and regulations. Most companies face the challenge of keeping up to date with the ever changing landscape of employment laws and regulations which typically vary from state to state. While there are a host of employment law issues that companies must be aware of and comply with, trends show that certain compliance issues present a greater risk of litigation (including class action litigation) than do others. The following is a summary of some of the employment law compliance issues which present greater risks of litigation in the food, beverages and AgTech industries.

California's Agricultural Labor Relations Act is the most vivid example of these principles. Agricultural workers are specifically excluded at the federal level from the union organizing protections of the National Labor Relations Act. In 1975, however, California's young, first-term governor shepherded a similar law through the state legislature, granting such protections to agricultural workers. The governor was Jerry Brown.

Some states (again including California, but also some other states) have promulgated regulations for different types of agriculture-related industries, including specific regulations for (i) industries preparing agriculture products for market, on the farm, (ii) canning and freezing and preservatives industries, (iii) industries handling products after harvest and, (iv) the catch all "agriculture industries." These regulations govern not just overtime pay and other wage-related obligations such as meal and rest breaks, but also child labor laws, bathroom facilities, and the like.

In some states, laws which govern employee pay and classification provide for awards of attorney's fees. This means that if your company is sued for a violation of these types of laws and any violation is found, your company will have to pay the attorney's fees of an employee who files a claim. Wage and hour violations on a large scale basis are often brought to court in class action litigation. This type of litigation is extremely expensive, and for the most part employment practice liability insurance policies have exclusions for wage and hour claims. Companies should thus be highly incentivized to take a proactive approach and regularly obtain a full review of their employment practices and the status of their legal compliance with governing laws and regulations.

On the federal level, in light of the differences between agricultural employment and other employment settings, such as with regard to part-time/full-time and seasonal work, the IRS has been as helpful as the IRS can be. In 2015 the IRS re-published its "Publication 51 (Circular A), Agricultural Employer's Tax Guide."

The following is a brief overview of some of the key types of employment laws and regulations which also present compliance risks.

1. **Minimum Wage**

   The Federal minimum wage is $7.25 per hour. Twenty-nine states (plus D.C.) have minimum wage laws. These range as high as $10.50 per hour. California's minimum wage is $9.00 per hour. Some counties and cities also have minimum wage laws. Before hiring employees in any state you must check the governing minimum wage in the jurisdiction where your employees will perform services for your company.

2. **Overtime Pay**

   An employer who requires or permits an employee to work overtime is generally required to pay the employee premium pay for such overtime work. Employees covered by the Fair Labor Standards Act (FLSA) must receive overtime pay for hours worked in excess of 40 in a workweek of at least one and one-half times their regular rates of pay. The FLSA does not require overtime pay for work on Saturdays, Sundays, holidays, or regular days of rest, unless overtime hours are worked on such days. The FLSA, with some exceptions, requires bonus payments to be included as part of an employee's regular rate of pay in computing overtime. Extra pay for working weekends or nights is a matter of agreement between the employer and the employee (or the employee's representative).

The FLSA does not require extra pay for weekend or night work or double time pay.

3. **Employee Classification: Employee vs. Independent Contractor**

   Federal and state laws heavily regulate employee classification issues. While the laws vary, they generally mandate that workers who do not control the nature, scope, materials and means of their work are employees. Working relationships which exceed over twelve months are particularly at risk of being determined by a taxing authority or other agency as an employer/employee relationship. Tax and other regulatory penalties for a misclassification can be extremely substantial.

4. **OSHA/Safety Compliance**

   Federal and state laws require companies to train employees in the safety and health aspects of their work. Employers are obligated to take steps to prevent injuries, illnesses and fatalities. Employers should have and follow robust compliance protocols.

5. **Gender Equal Pay**

   Federal and state laws prohibit wage discrimination by gender. This issue has recently garnered a lot of attention in the press, and we anticipate that companies in all industries will face increased scrutiny.

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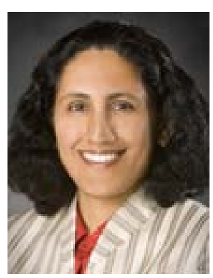
UNDERSTANDING FARM DATA



By Satya Narayan

Precision agricultural and the use of sensor technology and hi-tech systems in agriculture has resulted in large quantities of data regarding farm conditions, operations, and yields in the possession of agricultural technology providers. Agricultural technology providers or ATPs are constantly developing new software algorithms to organize and analyze farm data collected from different farmers to create meaningful information that farmers can then apply to, and improve, their farming practices. The organization and analyses of large data sets to produce meaningful information, commonly referred to as "big data analytics," has made it possible for farmers to adjust fertilizer and seed types and quantities for different portions of the same field to optimize yields. By combining and analyzing machine data from different farmers using its combines along with land area and usage data, John Deere has been able to forecast farmers' demands for spare parts of the combines. Big data analytics has even been used to predict and identify sick cattle more accurately than a cattle operator's evaluation of physical signs of sickness in cattle. Indeed, the American Farm Bureau Federation, while acknowledging the potential impact of big data analytics in agriculture, has said that big data can do for agriculture what the Green Revolution and biotechnology did for agriculture.

While big data analytics has resulted in improvements in farming, some farmers are concerned that, unless restrictions are imposed on the ATP's use and disclosure of farm data, ATPs might share farm data, including farm research and specialist practices, of one farmer with competing farmers or with third parties, such as environmental and animal welfare lobbies, in a manner disadvantageous to farmers. The American Farm Bureau Organization has voiced concerns on behalf of farmers that ATPs might use farm data to manipulate markets, since ATPs have real-time data on much grain is being harvested from tens of thousands of fields. There is also concern that ATPs might sell farm data to third parties in connection with marketing such third parties' own products and services without compensating farmers for the revenue generated by the ATP from the sale of their farm data. As a first step towards dealing with these concerns, a coalition of certain farm organizations, including the American Farm Bureau Organization, and certain ATPs, have agreed to a set of non-binding "Privacy and Security Principles for Farm Data" that they hope will be adopted by other ATPs.

The complete text of the Privacy and Security Principles for Farm Data is available here on the American Farm Bureau Organization's website. It reads very much like privacy and security principles for personally identifiable information, including that the ATP must provide farmers with notice that farm data is being collected and about how the farm data will be disclosed and used, about the types of third parties to which the ATP will disclose such data, and about the choices the ATP offers the farmer for limiting its use and disclosure. Among other things, it requires that an ATP's collection, access and use of farm data should be granted only with the affirmative and explicit consent of the farmer and that the ATP will not change the customer's contract without his or her agreement.

While on the face of it, adopting the Privacy and Security Principles for Farm Data seem non-controversial and good business practice for ATPs to help build customer trust, their application, without an understanding of the legal landscape and the difficulties in practical business implementation, is ill-advised. For instance, the different types of "farm data," which may include agronomic data, machine usage data, land data, personal data, and even associated weather data, are not created equal from a legal perspective in terms of assigning legal ownership to each type of farm data, or in their designation and treatment as business confidential information or as a trade secret, or in their designation and treatment as personally identifiable information (which is subject to the higher standard of privacy reserved for such information). ATPs should consult with legal counsel familiar with technology and data related contracts, to assist them with drafting an appropriate definition for "farm data" and appropriate contract clauses that help build customer trust but also do not create contractual representations of the ATP that would exceed a customer's rights granted by applicable law. Furthermore, ATPs adopting these principles should also consult with legal counsel about the frequency and nature of contract modifications that is necessitated by the rapidly evolving nature of technology and the work-flow process of complying with a contractual obligation to obtain customers' consent to contract modifications.

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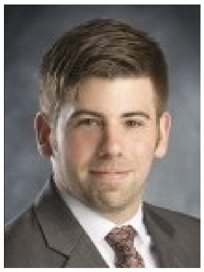
THE HAZY STATE OF MARIJUANA TAXATION



By Mark Mullin

State-legal marijuana businesses operate in a twilight zone: Legal for state purposes, but illegal for federal. In this gray zone, many tax traps hide, waiting for the unwary. This article will help make you a little more wary.

Let's begin by looking at marijuana businesses from the perspective of the federal income tax system. The feds see marijuana businesses as illegal operations, and, generally, the feds income-tax illegal businesses just like legal businesses. However, a closer look into this general rule reveals numerous exceptions. For example, businesses cannot take deductions for bribes and certain other illegal payments. Nor can businesses take losses when authorities seize their illegal property or income. And so on.

For marijuana businesses, chief among these exceptions is Internal Revenue Code §280E. Under §280E, businesses that traffic in controlled substances cannot deduct their expenses. As marijuana is a controlled substance under federal law, marijuana dispensaries and growers, even those legal under state law, are subject to §280E's limits on deductibility.

§280E causes dramatic consequences. Thanks to it, money-losing marijuana businesses may still have to pay income taxes! Fortunately for marijuana businesses, there are some techniques to reduce the pain of §280E. Unfortunately, they're not the simplest of techniques.

First, the marijuana business can attempt to capitalize as many costs into the cost of goods sold. ("Cost of goods sold" refers to the costs capitalized into inventory, which are not recovered until the inventory is disposed of.) This works because, per legislative history and because of potential Constitutional issues, §280E does not disallow reductions in income for the cost of goods sold.

This causes marijuana businesses to have unusual preferences. While other businesses prefer the instant hit of deductions over the slower cost recovery of capitalization methods, marijuana businesses prefer packing all of their costs into cost of goods sold, then slowly burning through their cost recovery as they make sales.

At first, marijuana businesses appear to have lucky preferences, and other businesses unlucky ones. This is because §280E increased the type of costs to be capitalized into the cost of goods sold. However, it really seems that only the government has lucky preferences: while non-marijuana businesses must suffer the higher capitalization rules of the post-§280E years, recent IRS guidance determined that the post-§280E changes *should not apply* for purposes of determining cost of goods sold under §280E. Effectively, the IRS's stance is that marijuana businesses must dig up the tax laws as they existed when §280E passed, and use them to determine the cost of goods sold. Whether the IRS's guidance is legally correct is an interesting question (for tax lawyers). Yet, marijuana businesses won't want to take on the IRS to find out.

Besides using cost of goods sold, a marijuana "business" may find itself trying to escape §280E by in fact consisting of multiple distinct businesses. The idea is this: Only businesses trafficking in controlled substances are subject to §280E. If taxpayers successfully segregate their other businesses from their marijuana business, the other businesses will avoid being dragged into §280E's deduction-denying vortex by the marijuana business.

This is not a simple strategy to pursue, however. Courts carefully apply a number of factors to determine whether activities *truly* constitute separate trades or businesses. For example, medical marijuana dispensaries that also provide caregiving services and lounges have attempted to treat those services as businesses separate from their dispensary. In these cases, courts have found the businesses to be separate only where the service business had many dedicated staff, actually took separate fees for these other businesses, and had other indicia that the other services were not simply incidental to helping the business sell marijuana.

It seems clear the income tax does not go easy on marijuana businesses. How might other taxes fare?

Let's begin with the payroll tax. For the payroll tax, the IRS penalizes most taxpayers who fail to electronically pay their employee withholding taxes. Unfortunately for marijuana businesses, few providers of electronic payments want to touch the semi-legal money of marijuana businesses. Thus, cannabis businesses often trade primarily in cash. Marijuana businesses thus have had difficulty meeting the IRS's electronic payment requirements. The IRS has previously abated these penalties for marijuana businesses, but more challenges await while this is sorted out.

Again, as with the broader income tax, this isn't great treatment. Perhaps states will be more favorable than the feds, you may think; many states consider marijuana legal, after all.

But in fact, states that legalize marijuana often levy heavy excise taxes on marijuana products. These rules vary by state, and have changed over time, and thus are not summarized here. (A consolation prize is that state excise taxes generally may reduce income taxes despite §280E. The idea is that, for income tax purposes, such state excise taxes may add to cost of goods sold, or may reduce the amount realized. In either case, such taxes are not deductions which §280E would block.)

Across the board, then, taxes offer many serious hurdles for marijuana businesses. Perhaps this will change; states might alter their own tax codes to treat marijuana businesses more like other businesses. Perhaps the federal government will amend or change its enforcement of §280E. But until such changes come, marijuana businesses will need to engage in careful tax planning to avoid turning to ash alongside their product.

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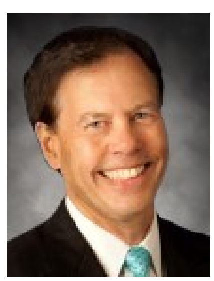
HAVE YOU COPYRIGHTED YOUR TRADEMARKS?



By Alan Haus

In December, Grumpy Cat Limited filed a lawsuit against one of its licensees over whether its license to sell coffee products was limited only to beverages, or whether the license also authorized the licensee to sell coffee beans. Regardless of the outcome, the instructive part of that case is that Grumpy Cat's legal claims include not only trademark infringement, but also copyright infringement.

The memorable photographic image of a cat with an odd expression (caused by feline dwarfism), that is familiar to many people, is federally registered as a trademark. When a company elects to legally protect an image as a trademark, however, that does not foreclose the possibility of registering the same image with the U.S. Copyright Office, as a work of visual art. The Grumpy Cat image is indeed also protected by copyright registrations.

Why would a company seek both trademark and copyright protection for the artwork of its logos? There are various advantages and disadvantages to the different legal regimes of trademark and copyright. Trademarks are almost always more difficult and expensive to register than copyrights. Also, when a trademark registration is granted, it applies only to the specific products or services registered, so that someone who uses a trademarked image on different products or services is not even committing trademark infringement. The clear disadvantage in enforcement of copyright, however, is that the owner must prove that the other party actually copied the image at issue; this contrasts with trademark rights in an image, which grant a monopoly on use of an image to sell the products or services - regardless of whether the infringer copied or even knew about the registered trademark.

Consider a company that is selling, say, alcoholic beverages that are branded with a distinctive design image, and the company registers the design as a trademark for alcoholic beverages. If another company comes along and sells bartender accessories with a confusingly similar design, it is probably not infringing the registered trademark. If there is evidence that the bartender accessories company copied and modified the beverage company's design, however, then the accessories company has committed copyright infringement. There are also differences between the two legal regimes with respect to geography. Trademark protection is territorial, so that one must use the trademark and obtain registration in say, Canada, to have trademark legal rights there. In contrast, under international treaty, a copyright is generally enforceable in most countries based on a company's U.S. copyright registration.

The alcoholic beverages company may indeed never even have the legal right to register its design as a trademark for bartender accessories, or other products or services. Registration of a trademark (and for that matter, even common law rights in unregistered trademarks), require that the company use the design as a brand to sell the other products or services. The company that is selling only beverages will thus likely be precluded from claiming trademark rights outside of the product category of beverages.

Even if the beverages company starts selling some accessories, it would be necessary for it to register the trademark in multiple trademark "classes" - one for glassware, another for clothing, and additional classes for other types of products. Each trademark class sought triggers a $325 filing fee at the U.S. Patent & Trademark Office, and subjects the company's claim of trademark rights in each category to the scrutiny of a Trademark Examining Attorney.

In contrast, copyright law protects against unauthorized copying of the image for any use. The beverage company that is not yet selling other products or services is thus best advised to obtain trademark registration for the design as applied to beverages, and copyright registration, too.

Does a company really need to register the design with the Copyright Office in order to have legal protection? The answer is that in order to have any meaningful protection, the copyright must be registered. There was a change in U.S. copyright law in 1989 which has been widely misunderstood. Before 1989, an author of a copyrightable work that did not register the work forfeited the right to claim copyright ownership, and the work became part of public domain. That law was changed, so that delay in registration no longer results in loss of the author's claim to copyright ownership. Many people incorrectly believe that this means that it is not necessary to register one's copyrights. What has not changed, however, is the following: a copyright owner cannot go to court to enforce legal rights unless and until the copyright is registered. And in light of current backlogs at the Copyright Office, copyrights cannot be registered quickly, such as after infringement has occurred.

Undertaking the process of seeking copyright registration is also useful in that it sometimes exposes oversights in actual ownership of the intellectual property. Companies will sometimes hire an outside design firm to create a design that they plan to use as a trademark. Companies often believe that when they request a design and pay the agreed-upon price, they become the owner of the copyright in the design. In fact, however, if there is not a mutually signed "work for hire" agreement, or a copyright assignment from the design firm, the company probably does not own the copyright in the design. Thus, attending to this as part of the copyright registration process will confirm for the company its ownership of all aspects of its valuable copyrights and trademarks.

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Short Takes

GMO Salmon

After twenty years of swimming upstream, "AquAdvantage" salmon has been approved by the U.S. Food and Drug Administration (FDA) as the first transgenic animal available for human and animal consumption. The FDA has determined that the fish is safe to eat, the DNA construct is safe for the salmon, and the company had met all of the conditions of the statute and regulations. Each of the salmon will grow to marketable size in half the time that it takes to grow farm-raised Atlantic salmon that are not genetically engineered. The AquAdvantage salmon can grow more quickly because they contain DNA from the Pacific Chinook salmon and ocean pout, another type of fish, which enables the salmon to grow year round instead of only during spring and summer. Opponents of genetically modified organism (GMO) breeding may yet file lawsuits challenging the FDA approval, however.

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Country of Origin Label Law Repealed

Do you care where your meat was born, raised, or slaughtered? According to the World Trade Organization (WTO), it should not make a difference. Last December, Congress was forced to repeal the "country of origin labeling" (COOL) rule for beef, pork, and chicken. First introduced in 2002 as a response to mad cow disease, product of origin labels allowed consumers to avoid foods produced in countries with weaker safety regulations. After the labels were fully implemented in 2009, Canada and Mexico filed suit with the WTO claiming discrimination against imported livestock. After years of legal wrangling, the WTO decided that COOL rules imposed "a disproportionate burden on producers and processors of livestock that cannot be explained by the need to provide origin information to consumers." American consumers are thus required to rely solely on the efficacy of USDA inspection for their food safety.

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"Candy" Is Descriptive, Even When It's Not Describing Candy

Are phrases that start with a word or two and end with "Candy" generally understood in modern American English to mean something that's desirable? Many people would understand the phrase "eye candy" to mean that. But what about "Bacon Candy" for bacon? And do people understand "Meat Candy," when displaying meat at a food kiosk, to merely mean that desirable meat is served? The U.S. Patent & Trademark Office (USPTO) has answered "yes" to these questions. As a result, recent applicants for trademarks that included "Bacon Candy" and "Meat Candy" were not able to obtain trademark registration for those terms on the USPTO's Principal Register.

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You Say "Nut," I Say "Nut (wink)"

In keeping its finger on the pulse of cultural developments, the U.S. Patent & Trademark Office not only navigates the bleeding edge of issues like the snarky use of the term, "Candy;" it is also by law required to refuse registration to proposed trademarks that contain "immoral or scandalous matter." Within the past few months, the USPTO had to decide cases in which two wily brewers used the term "nut" in ways that alluded to the scrotum. The legal test is whether a substantial composite of the general public would consider a term scandalous. The applications were for "Nut Sack Double Brown Ale," and for the "Left Nut Brewing Company." While close decisions, in both cases the trademark office found that the terms were not scandalous, based on a mixed bag of evidence of offensiveness.

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Environmental Tragedy, Compounded

On December 19th the U.S. Department of Justice filed an environmental lawsuit against California-based Gibson Wine Company. The case serves as a reminder that use of equipment and chemicals in food and beverage processing makes these industries particularly vulnerable to environmental regulatory issues. In 2012 a worker at Gibson

Wine was killed by a leak of an ammonia cloud that was released when a supervisor may have been distracted in conversation and opened the wrong valve. The company allegedly did not have a training and evaluation program for employees who operated the valves, have proper emergency equipment, and failed to implement a proper emergency response plan. The government also claims that after the release the company waited 37 hours before reporting the incident, in violation of the requirement of immediate notification under both the general CERCLA environmental statute, and the specific Emergency Planning and Community Right-to-know Act (EPCRA).

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