NEWS

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News and Views for Your Hospitality and Franchise Business

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Spring 2013

This is an advertisement.

FTC Ruling Not So Wonderful For POM or The First Amendment

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On January 16, 2013, the U.S. Federal Trade Commission (FTC) issued a final ruling in a case about the advertisements for POM Wonderful LLC's 100% Pomegranate Juice and POMx supplements. These ads, 43 in total, made various claims about the general health benefits of POM products, as well as their abilities to treat or prevent certain diseases.

Continue on page 2

When You Check Out, Don't Forget the Shampoo:

Hotel Consumables Qualify for the Texas Resale Exemption from Sales Tax

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Hotels stock rooms with soaps, shampoos, conditioners, mouthwashes, shower caps, pens, notepads and similar non-reusable consumable items (hotel consumables) for the use of hotel guests. Guests are free to use the items, not use the items or take the items with them upon checkout. A guest is not offered a room at a reduced rate if she does not want or does not use the hotel consumables.

Continue on page 3

Multiple Dangers of Meth Labs in Hotels

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A quick Internet search sheds a bright light on the dangers to hotels if guest rooms are used for methamphetamine, or "meth," production. There are dangers related to contamination and its impact on other guests, as well as cleanup costs. Also, dangers exist to guests and staff from exposure to the people involved in meth production and distribution. Finally, there are reputational dangers to the hotel brand and/or the business of the particular hotel establishment.

Continue on page 4

Greetings From Hospitalitas

Hospitalitas is the Baker Donelson newsletter for our clients and friends in the hospitality industry – hotels, restaurants and their suppliers. It is published several times a year when we believe we can deliver first-class, useful information for your business. Please send us your feedback and ideas for topics you would like to know more about. True to our Southern heritage of hospitality, we'll work hard to make each visit with us something special and worth repeating.

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IFA Legal Symposium Report

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For our readers who did not attend the early May International Franchise Association Legal Symposium held in Washington, we pass along these observations:

- State legislative interest in new franchise relationship laws spans the continent, from Maine to California. Although no new relationship legislation is likely to be enacted, bills introduced in California, Maine, Massachusetts and Rhode Island were deferred for additional study, with the potential to revive next year. The impact of these bills ranges from mildly disruptive to reshaping franchise relationships. If enacted in their present forms, many franchisors will likely avoid franchising in the states where enactment occurs, at least until the price of added legal risk can be factored into the fee structure. A grass roots coalition of franchisee associations is gathering strength, and state legislators who abhor business interests curiously seem to gravitate to these anti-consumer bills.

Continue on page 6

FTC Ruling Not So Wonderful For POM or The First Amendment, *continued*

The FTC upheld Chief Administrative Law Judge (ALJ) D. Michael Chappell's decision that the advertisements deceptively advertised the products, because POM did not have adequate scientific support for claims that the products could treat, prevent or reduce the risk of heart disease, prostate cancer and erectile dysfunction. The FTC noted that no clinical studies had been done on the products' effectiveness, so there was no clinical proof they could work as the advertisements suggested.

The FTC's opinion actually went beyond the ALJ's initial opinion. The commission found that POM made deceptive claims in 36 of 43 separate advertisements and promotional materials, whereas ALJ Chappell only found that 19 of the 43 challenged items were false or deceptive.

The commission's final order bars POM from claiming that its drinks and supplements are "effective in the diagnosis, cure, mitigation, treatment, or prevention of any disease," including heart disease, prostate cancer and erectile dysfunction, "unless the claim is supported by two randomized, well-controlled, human clinical trials." The order also prohibits misrepresentations regarding any test, study or research, and requires competent and reliable scientific evidence to support claims about the "health benefits, performance, or efficacy" of any food, drug or dietary supplement.

The commission's opinion was important because, for the first time, the FTC found that a health claim need not include the words "established" or "clinically proven" in order to be held to standards that require two randomized, well-controlled, human clinical trials. The opinion suggests that two randomized, controlled trials (RCTs) are now required to support any kind of disease prevention or treatment claims. The opinion strongly suggested that at least one such RCT is required for more general claims of healthfulness.

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FTC Ruling Not So Wonderful For POM or The First Amendment, *continued*

One issue that the FTC opinion did not seriously address was POM's First Amendment rights to make health-related claims. The commission held that because it had determined that the ads were misleading, no analysis under the U.S. Supreme Court's rulings on commercial speech, including the factors from *Central Hudson Gas & Electric Corp. v. Public Service Commission*, was necessary.

Importantly, the opinion ignored the Supreme Court's recent *U.S. v. Alvarez* decision where it held that it "has never endorsed the categorical rule the Government advances: that false statements receive no First Amendment protection." Even if they determine that the speech is misleading, courts across the country will generally continue to apply all of the *Central Hudson* factors to determine if the commercial speech at issue is prohibited, even if they do so while applying more strict scrutiny. Not surprisingly then, on March 8, 2013, POM filed a petition for review of the FTC's decision in the D.C. Circuit Court of Appeals, arguing primarily that the FTC's order unconstitutionally violates POM's First Amendment rights.

Given the remaining uncertainties of POM's available First Amendment defenses, and the resolution of the D.C. Circuit appeal, advertisers and manufacturers now need to be very cautious when making any disease treatment/prevention claims with respect to food and dietary supplements. The FTC wants to establish the two-RCT requirement as the standard for making health benefit or disease treatment claims in any food, drink or supplement advertisement, label or promotional material without undertaking a formal rulemaking procedure or issuing any industry guide or policy statement. For health claims alone, the FTC "competent and reliable scientific evidence" standards remain in force, but the POM opinion suggested that one or two RCTs may now be required for general health claims. What the FTC does provide is a simple formula for display of the "healthy" claim for food products or menu items. For example, with all of the research studies on the "Mediterranean diet" published recently, can restaurants with Mediterranean diet menus claim their menus feature healthy dishes? Does the POM decision plant a seed of doubt about what were thought to be settled principles of advertising regulation?

When You Check Out, Don't Forget the Shampoo:
Hotel Consumables Qualify for the Texas Resale Exemption from Sales Tax, *continued*

In *DTWC Corporation v. Combs*, Red Lion Hotels, Inc. operated a hotel in Austin, Texas (DWTC was the successor-in-interest to Red Lion). Red Lion charged a hotel guest asset fee for overnight lodging, which was subject to state and local hotel occupancy taxes. In addition to the use of a hotel room and access to hotel facilities, such as a swimming pool and exercise facility, guests were free to use the hotel consumables as they saw fit.

The hotel consumables were not manufactured by Red Lion. Rather, Red Lion purchased the consumables from suppliers and then provided them in each hotel room for use by its guests. In an April 11, 2013 decision, a Texas Court of Appeals ruled that Red Lion's purchases of the hotel consumables from its suppliers qualified for the Texas resale exemption from Texas state and local sales

Continue on next page

taxes. According to the court, the consumables were tangible personal property purchased by Red Lion, placed in a hotel room for use by its guests in the same form or condition in which the consumables had been purchased by Red Lion, and the hotel guests paid a fee (i.e., consideration) to use a room and its amenities, including the hotel consumables. As a result, the Court of Appeals held that the hotel consumables qualified for the resale exemption when Red Lion purchased them from suppliers.

The reasoning of the Texas Court of Appeals in *DTWC Corporation* could also apply to other states and their resale exemptions. In addition, certain types of services purchased by a hotel that are normally subject to sales tax may also be eligible for resale exemptions. For example, in *Hyatt Corp. v. Limbach*, 69 Ohio St. 3d 537 (1994), the purchase of cleaning and laundry services by a hotel (which were services subject to Ohio sales tax) qualified for the Ohio resale exemption. The benefit of the service provided was determined by the Ohio Supreme Court to have been resold to hotel guests in the form of clean linens.

Hotel operators should review their sales tax returns, as well as their sales tax policies and procedures, to determine if they are taking advantage of available resale exemptions. If sales tax has been paid on purchases of hotel consumables (and possibly certain services), consideration should be given to filing sales tax refund claims. And, as for hotel guests, don't take the linens, but remember to take the shampoo.[1]

Multiple Dangers of Meth Labs in Hotels, *continued*

Meth makers prefer to produce meth in hotel rooms to reduce the danger of contaminating their own properties. But the production of meth is highly volatile, and if it is occurring in hotels, producers put other guests and staff, as well as the structures themselves, at risk. An explosion during production could cause major damage to a hotel and put other innocent guests in danger of serious injury or death.

In addition, meth makers typically are using the drug while they are producing it. While on meth, an individual can go without sleep for days and experience paranoia and delusions, sometimes reacting violently due to lack of sleep, meth addiction and hallucinations. Meth makers typically produce the drug during the middle of the night, and if other guests knock on the door of a hotel neighbor because of noxious noise or odor, it could put the guest's life at risk. Meth makers almost always have weapons in their possession. These same risks are equally applicable to hotel staff. Safety focus and adequate training are key for lodging establishments to protect guests, staff and structures.

In the last ten years, there have been over 3,000 reported meth labs in hotel rooms. Yet statistics indicate that nearly 70 percent of all contaminated properties, including hotels and motels, are not reported. According to the American Hotel and Lodging Association (AH&LA), a meth lab can be set up and producing meth in less than four hours, and meth producers usually do so between midnight and 4 a.m. According to Joseph McInerney, former president and CEO of AH&LA, "meth lab cooks may check into the hotel late at night and cook their meth through the night before leaving early the next morning." Older properties tend to attract meth producers, who typically will rent a room with direct access to a parking lot, and will request a room away from the front desk office.

[1] According to the Court of Appeals in *DTWC Corporation*, "DTWC asserts that the cost of the hotel consumables is factored into the room rate, thus settling, at least on this record, the dilemma of whether it is okay to take these items home with you when you check out of your hotel room."

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Multiple Dangers of Meth Labs in Hotels, *continued*

While setting up a meth lab in a hotel room is advantageous for meth makers, it is extremely expensive for the hotel industry, both in physical risk and liability. The cost of decontaminating a single room can range from $2,000 to $20,000, according to AH&LA. As with many crimes, it is the innocent victims who suffer the consequences of meth lab production in hotel rooms. Guests, as well as staff, may be exposed to dangerous chemicals. The threat of an explosion is a serious one. Based on available statistics, there is a substantial risk that guests are renting rooms that have been used as meth labs and have not been decontaminated. Guests who stay in these rooms may experience asthma-like symptoms, irritated eyes and/or skin, or extreme nausea. Traces of toxic chemicals used to produce meth can last more than a decade.

How can hotel owners and guests protect themselves? Hotel owners should implement training as part of the overall safety and security program and maintain a good working relationship with local law enforcement, who can train hotel staff on what to look for when guests check into a property. Meth can be made in coffee pots or plastic bottles, and the over-the-counter drug pseudoephedrine (now subject to buyer disclosure at the time of purchase) is a key ingredient. Hotel cleaning staff should be watchful for these types of items in trash as well as large amounts of trash left in a room. The actual production of meth causes significant toxic odors.

If a guest room has been contaminated, the operator would be well-advised to contact a local fire and recovery clean-up business that is specifically trained in meth lab decontamination. It is critical that the decontamination be done properly by trained crisis cleaning providers and state laws usually require it. Some states also require certification that the property is safe before it can be occupied again.[1] Typically, a room will have to be stripped of the interior furnishings, flooring and drywall and rebuilt from the structural framing out. In addition, a hotel owner should have any staff who may have been exposed to a meth lab examined by a physician and tested for any symptoms that could result from exposure.

There is a very real reputational risk that media reports of a meth lab discovery can negatively impact a hotel's business and the hotel brand's image and public perception, which in turn may affect other independent hotel owners operating under the brand's flag, because guests will likely avoid a hotel that has had a reported meth lab incident. To minimize potential consequences, hotel owners should be proactive in staff training, reporting potential issues and cooperating with local law enforcement. Not reporting a suspected meth lab can have serious consequences for the hotel's business and viability in the long term. In addition, willful ignorance of the existence of a meth lab is no longer a defense and can potentially result in criminal liability. In Tennessee, for example, it is a felony for a person to permit another to use a structure owned or controlled by that person for meth production or with reckless disregard of the meth producer's intent.[2] As a result, property owners cannot simply ignore the problem and refuse to report suspected meth lab activity.

[1] Tenn. Code Ann. §68-212-502 and §68-212-505

[2] Tenn. Code Ann. §39-17-433(a)(3)

IFA Legal Symposium Report, *continued*

- Efforts to enact independent contractor laws in Delaware, Massachusetts and Washington to mirror similar legislation recently enacted in Georgia may not be successful this year. Independent contractor laws prohibit state unemployment and workers' compensation insurance funds from treating franchisees as if they were employees of the franchisor, as long as the franchisee has signed a franchise agreement.

- A Minnesota bill to prohibit franchise non-competition covenants and a Nevada bill to enact a "Fat Tax" on quick service restaurant menu items having high calorie counts are not likely to move forward.

- The IFA's Task Force to work with the U.S. Small Business Administration on issues of eligibility for the SBA Franchise Registry reports progress. The Task Force focused on certain key issues where the Franchise Registry eligibility criteria and common franchise agreement terms and conditions clash, particularly on the issue of "one size fits all" criteria used by SBA and Frandata, the contractor for the Registry.

- Franchise disclosure legislation and regulation is likely to arrive for British Columbia in 2014.

- The IFA continues to monitor the *Patterson v. Domino's Pizza* case in California as the appellate decision is reviewed by the California Supreme Court. The case involves a claim that the franchisor should be vicariously liable for the franchisee's alleged violation of workplace discrimination rules.

- While there was no seminal case decision that created buzz among practitioners, many cases discussed by presenters focused on the issue of how much control a franchisor asserted over its franchisees. These cases arose in the contexts of several categories of employment law claims by employees and states against employers, as well as the traditional vicarious liability claims for personal injuries and property damage. Franchisors were unable to extract themselves from cases alleging franchisee violations of fair housing, civil rights, credit reporting and telephone solicitation laws. Courts continued to struggle with agency law principles, and inconsistently analyzed whether liability could be predicated on the mere right to control invested in the franchisor, or whether something more in the nature of the franchisor's asserting the right to control should prevail.

- The opening plenary, moderated by this author, offered the attendees a point-counterpoint perspective on franchise relationship issues. Panelists Ken Walker, former IFA chairman and CEO of franchisor Driven Brands, and Aziz Hashim, CEO of a large multi-unit, multi-brand franchisee, traded views on a number of key issues facing franchising, such as whether an appearance on the *Undercover Boss* television show, where 43 percent of the shows were about franchised businesses, is a good idea for the franchise system. They also shared consensus on a set of guiding principles that they have been debating as part of a broader industry task force. These principles are:

  - Market forces create the climate for substantive changes in franchising.
  - Clarity and transparency will strengthen franchising.
  - The franchise agreement – nothing else - governs the legal relationship between franchisor and franchisee.

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IFA Legal Symposium Report, *continued*

- Successful systems require profitable and sustainable franchisees and franchisors.
- Franchisees should have the opportunity to monetize their equity (if any) at the end of the relationship.
- Franchisors should have the right to determine the terms of their franchise offering.
- Franchising is a unique business model.
- Franchisees should clearly understand the franchise business model before investing in a franchise.
- Franchisors should clearly understand the franchise business model before choosing this method to develop their business concept.

A video of the opening session panel is posted on Baker Donelson's website.

Quick Takes

Baker Donelson Rolls Out L&E Guides

Whether you are double-checking something you already know or need to learn about a new legal issue, Baker Donelson's *Quick and Easy Guides to Labor & Employment Law* are for you. Covering the basics of the federal rules as well as those in ten states, the topics cover issues our clients most often ask about and address the basics that human resources professionals encounter on a daily basis. While these guides are certainly not intended to provide a "law-school" thesis on these issues, they will provide a useful reference tool for HR professionals or anyone tasked with the HR function at their small business.

Visit the URL below to get started.
http://inside.bakerextranet.com/practice/LE-EZGuide/default.aspx

Firm Earns Highest Ranking To Date On FORTUNE's "100 Best Companies to Work For" List

Baker Donelson has earned its highest ranking to date on FORTUNE's annual "100 Best Companies to Work For" list, coming in at 45th in its fourth consecutive year to be named to this prestigious listing.

"Each year, we are incredibly honored to be recognized among such a select group of companies," says Ben Adams, the Firm's chairman and chief executive officer. "This year, as we celebrate our best showing ever, I'm grateful to our employees because they are the reason Baker Donelson is a great place to work, and their dedication to the Firm, our clients and our communities is what sets us apart."

In naming Baker Donelson to the list, FORTUNE noted that the Firm "prides itself on doing the right thing" and highlighted the Birmingham office, which formed in the 1960s "as a refuge for Jewish and Catholic lawyers involved in the civil rights movement."

Continue on next page

Quick Takes, *continued*

Buckberg A Seventh-Year "Eagle"

For the seventh consecutive year, Joel Buckberg, co-leader of Baker Donelson's Hospitality, Franchising and Distribution Group, has been named a Legal Eagle by *Franchise Times*, a national publication for franchisors and multi-unit franchisees. This annual listing recognizes franchise law attorneys on the basis of input from their peers and clients, and includes leading franchise attorneys across the country. To be included as a Legal Eagle, attorneys must be nominated by their peers or clients and must meet the criteria of the *Franchise Times* editorial panel.

New Hospitality Attorneys To Serve You

We have had a number of new faces join Baker Donelson's group since our last issue:

Shameak B. Belvitt is an associate in the Nashville office and is also a member of the Corporate/Mergers & Acquisitions, Emerging Companies and Business Technology Groups. She represents large corporations, vendors to such corporations, and emerging companies in procurement transactions and licensing agreements. Shameak also regularly advises companies regarding privacy policies, website terms of use, software development agreements and electronic contracts governing online services. She has experience in corporate formation and other general business transactions.

Carla Gunnin is a shareholder in Atlanta and focuses her practice on labor relations matters and occupational safety and health issues. She has a national practice, litigating cases before federal and state administrative tribunals throughout the United States in matters of Occupational Safety and Health (OSHA) law and Mine Safety and Health (MSHA) law. With her prior experience as a trial attorney for the DOL, Carla has a strategic advantage in representing employers in OSHA, MSHA and U.S. Department of Labor (DOL) matters. Since going into private practice, she has successfully handled OSHA matters involving egregious citations, willful citations, fatality-related citations and complex multi-employer worksite issues. In addition, she has represented employers in a wide variety of DOL issues.

Stephen Hargraves is an associate in the Firm's Nashville office, where he is also a member of the Securities/Corporate Governance Group and the Corporate/Mergers & Acquisitions Group. He represents public and private companies in a variety of capacities, including transactional, corporate governance, securities and hospitality, franchising and distribution matters. Stephen's experience includes mergers and acquisitions, private equity and venture capital transactions, business entity formation and general corporate matters, preparation and review of Securities and Exchange Commission filings, and Securities Act compliance.

Continue on next page

Quick Takes, *continued*

New Hospitality Attorneys To Serve You

Marty Hartley has joined the Firm as shareholder in Orlando and focuses her practice on representing international and domestic developers and commercial property owners in the acquisition, development, finance and disposition of commercial real estate, including resorts, hotels, mixed use, condominiums and affordable housing projects. Marty also has more than 25 years of experience in corporate practice and taxation, including mergers and acquisitions, entity formation and business succession planning. She has substantial experience in association law, public finance and franchising. She practiced as a certified public accountant prior to embarking on her legal career, and incorporates this knowledge into her practice.

Dispatch From Our Franchise Colleagues in Canada: British Columbia Contemplating a Franchise Act

In March 2013, the British Columbia Law Institute published a "Consultation Paper on a Franchise Act for British Columbia," which includes a review of the structures of various types of franchise systems, the legal framework of the franchise relationship and franchise legislation existing in five other provinces of Canada, the United States and Australia. The International Institute for the Unification of Private Law (UNIDROIT) Model Franchise Disclosure Law (Rome, 2002) is referred to as the proper model for a Franchise Act for British Columbia, although with some important variations. If the British Columbia Legislature enacts a Franchise Act (which it likely will), that province will be the sixth out of ten Canadian provinces to have franchise legislation. Click here for the full text of a recent alert on this topic from our franchise colleague at Davis LLP in Canada, John Rogers.

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Continue on next page

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