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The Hospitality Industry Newsletter from Baker Donelson

Customer Service or Union Organizing – NLRB Sets Hotel Priorities

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A recent decision of the National Labor Relations Board (NLRB) addressed several work rules that impact the hospitality industry. The first rule raised the question of to what extent a hotel can lawfully control the solicitation and distribution activities of its employees on the hotel's premises.

At issue was a work rule which prohibited employees from circulating petitions and soliciting memberships "during the working time of either

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Department of Labor Issues Proposed FMLA Regulations

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On January 28, 2008, the Family Medical Leave Act (FMLA) was amended by the National Defense Authorization Act for Fiscal Year 2008 to provide up to 26 weeks of job protected family leave to care for injured members of the Armed Forces, and up to 12 weeks of leave because of a qualifying exigency arising out of an employee's parent, child, or spouse's active duty or call to active duty. Under the amendment, a maximum of 26 weeks of leave may be taken during a 12-month period for any combina-

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Franchise Agreements in Bankruptcy: Fiasco or Fortuity

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Your franchisee files bankruptcy; is this good news or bad news? It could be either depending on whether the debtor wishes to keep the franchise in place or plans to let it go. The Bankruptcy Code has special rules on how a debtor can treat this type of agreement where it was entered into prior to the filing of the bankruptcy and remains in effect as of the time the case was filed.

A franchise agreement which is in effect at the time a bankruptcy case is filed is an executory contract. The Bankruptcy Code has special provisions about how executory contracts — such as franchise agreements to which the debtor is a party — are treated. These rules do not apply where a franchise agreement was properly termi-

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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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the employees to whom non-company literature is being distributed or any time in working areas or in customer and public areas." *Crowne Plaza Hotel,* 352 NLRB No. 55 (2008). The rule appeared in a handbook issued to employees of Crowne Plaza Hotel at Crowne Plaza's property in Rochester, New York. The property was franchised and operated by the franchisee.

In addition to issuing the handbook, the Crowne Plaza management declared that all public areas at the hotel, including parking areas, sidewalks and public restrooms, were "guest service areas" where employees could not engage in any activities that might interfere with "customer satisfaction." That approach is consistent with "guest-centric" brand standards that focus on the guest environment and guest experience. As hotel brands are devoted to measuring guest satisfaction and judging franchisee performance on the basis of guest feedback, management's attention to customer satisfaction has become a major emphasis.

In support of a complaint issued against the Crowne Plaza franchisee, the General Counsel of the NLRB claimed that the handbook rule (and by implication any similar brand standard) unlawfully interfered with employees' right to protest working conditions because it denied employees the right to engage in solicitation and distribution activities in public areas during their non-working time. The complaint was based upon an unfair labor practice charge filed against the hotel by the union UNITE HERE.

In its defense, the hotel franchisee pointed out that in certain establishments, including casinos, restaurants and retail stores, employees may lawfully be prevented from engaging in solicitations and distribution activities in customer service areas. From this, it argued that unlike a casino, restaurant or retail store, a hotel lacks specific identifiable customer service areas, and therefore, the maintenance of a rule prohibiting solicitation and distribution in all areas open to customers is necessary "to curtail employees from interrupting customer satisfaction."

The NLRB, however, noted that under established precedent, employees could not be restricted from engaging in solicitations and distributions in strictly public areas such as public restrooms and restaurants or, as in the case of casinos, they could not be restricted from engaging in such activities beyond aisles and corridors located adjacent to gambling areas, citing *Santa Fe Hotel & Casino*, 331 NLRB 723, 729 (2000). The NLRB concluded that employees would read the rule as prohibiting them from engaging in protected activities in purely public areas, and, as a result, the agency found that the rule was an overly broad restriction on rights protected by Section 7 of the National Labor Relations Act. Thus, the agency concluded that the Crowne Plaza franchisee had maintained the rule in violation of Section 8(a)(1) of the Act.

In a 2007 case, the United States Court of Appeals for the District of Columbia Circuit, held, in agreement with the NLRB, that a casino violated the Act by having police remove union demonstrators from the casino's privately-owned sidewalk. *Venetian Casino Resort, L.L.C. v. NLRB*, 484 F. 3d 601 (D.C. Cir. 2007). In this case, the casino repeatedly warned demonstrators that they were trespassing on private property and that if they did not leave, they could be arrested. The court held that the casino's property interest in the sidewalk did not entitle it to take action interfering with employees' protected right to protest working conditions and to seek union representation.

In the Rochester Crowne Plaza case, the NLRB held that in addition to unlawfully

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Hospitality Briefs

by Joel Buckberg

Franchise Rule Changes In Effect; NASAA Speaks

On July 1, 2008, the Uniform Franchise Offering Circular (UFOC) passed into franchise history. The Franchise Disclosure Document (FDD) officially replaced the UFOC as the disclosure document to be used for all franchises sold in the United States under federal and state franchise laws and regulations. Use of the UFOC for new disclosures is prohibited under the Federal Trade Commission's revised Franchise Rule (16 C.F.R. Part 436).
In a rare showing of regulatory harmony, the North American Securities Administrators Association Franchise Committee, the representative body of state franchise regulators, published its final recommendations on state franchise regulations on June 30. The case material is available at www.nasaa.org/content /Files/ 2008UFOC.pdf. The regulators provided some additional guidance on the ancillary forms and filings that are needed for franchise registration, as well as their interpretations of the FDD format instructions of the Federal Trade Commission. Combined with the FTC's Compliance Guides and updated list of Frequently Asked Questions, all of the anticipated regulatory guidance for FDD drafting has now been published.

Notably, the NASAA publication has simplified the filings for franchise sales people and eliminated their birthdates, home addresses, home telephone numbers and social security numbers from the public record filing. That change will substantially reduce the risk of identity theft from these documents. However, NASAA indicates that franchisors should update their registered list of franchise sellers monthly as the roster of franchise sellers changes.

Public Company Franchisors May Need to Add to FDD Financial Statements

Public company audit opinions published in public company disclosure documents filed with the Securities and Exchange Commission are more complex under new rules enacted with the implementation of

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maintaining an overly broad no solicitation/no distribution rule, the hotel owner violated the National Labor Relations Act by maintaining a rule which prohibited employees from communicating with the media concerning events occurring on hotel property. In particular, it was held to be unlawful for the hotel management to tell employees that the hotel's general manager was the only employee authorized to furnish information to the news media. The NLRB held that this directive encroached upon the right of employees to communicate complaints about working conditions to the press.

Further, two other Rochester Crowne Plaza work rules were found to be unlawful on grounds that they restricted the right of employees to engage in a strike during the middle of a work shift. One of these rules prohibited employees from leaving their work areas during work time without authorization from management, while the second prohibited employees from "walking off the job." The NLRB found both rules to be overly broad, and therefore unlawful, on the basis that they infringed upon employees' unfettered right to engage in a concerted work stoppage for the purpose of protesting working conditions.

We note for the record that in March 2008, the general manager of the Rochester Crowne Plaza, Paul Kremp, announced plans for a major renovation to be carried out in conjunction with a change in the name of the hotel to the Rochester Plaza Hotel and Conference Center. No information is available as to whether the two events are related.

Hospitality operators should note that the legality of a work rule frequently turns on the particular facts of a case. For that reason, employers wishing to adopt new rules or revise existing rules may find it beneficial to consult a lawyer knowledgeable in labor matters before making additions or revisions. Periodic review of employer's work rules is helpful to assure that they conform to the NLRB's current interpretation of the statute.

Mr. Young is an attorney in our Memphis office.

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Sarbanes-Oxley legislation (SOX). Management is obligated to establish and maintain adequate internal control over financial reporting, among its other responsibilities under SOX. There are suggested frameworks for review of this obligation and publication of the results of that review in an annual report. These disclosures are found at Item 9A of Form 10-K. The auditors have the option of including their comments on management's annual report on internal control over financial reporting in their audit opinion or in a separate opinion. At least one Big Four accounting firm is requiring its audited franchisors to include in their Item 21 Financial Statements not only the audited financial statements and related audit opinion, but a copy of Item 9A from the franchisor's Form 10-K. This goes beyond the mandates of the FTC and the states, but the FTC has made clear in the Statement of Basis and Purpose published with the revised Franchise Rule that it defers to the SEC on matters of accounting and public company compliance.

We offer experienced counsel in the area of SOX compliance through our Securities Group, led by Gary Brown (Nashville, 615.726.5763, gbrown@bakerdonelson.com), and in establishing internal controls for franchise activity through our Franchise Group, led by Joel Buckberg (Nashville, 615.726.5639, jbuckberg@bakerdonelson.com).

Domino's Wins Reversal of POS Specification Case

Domino's Pizza lost a hotly contested case brought by franchisees over specification of a proprietary point of sale computer system at the trial court level. A Minnesota federal court held that the forms of franchise agreement used by Domino's did not allow the franchisor to specify itself as the sole supplier of a point of sale computer system for its franchisees. The lawyers for the franchisees trumpeted the victory as a major win for franchisees who wanted to select their own vendors for their point of sale systems.

The language in question is typical in franchise agreements: "We will provide you with specifications for …computer hardware

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Department of Labor Issues Proposed FMLA Regulations, *continued*

tion of the FMLA-qualifying events. Then, on February 11, 2008, the Department of Labor (DOL) issued much-anticipated proposed regulations for implementing the FMLA. These rules, which seek to clarify existing regulations, were open for public comment for a 60-day period, but the comment period closed on April 11, 2008. Although the DOL has not summarized or published the comments to date, it plans to complete the review process and adopt the new regulations prior to January 2009, when President Bush leaves office. Additionally, although this release does not include specific proposals for implementing the new leave provisions for family members of military personnel, the DOL did seek public comments on such rules.

While the proposed regulations do not provide as much relief from administrative burdens and confusion as employers had hoped, it is important that employers understand the major areas of difference between the proposed regulations and the existing regulations.

Employee Eligibility Standards

In order to be eligible for the FMLA leave, an employee must have 12 months of service with his or her employer and have worked at least 1,250 hours during that 12-month period. The months of service need not be consecutive, but the proposed regulations clarify that employers are not required to count prior periods of employment which occurred before a break in service of more than five years. Exceptions are made to this rule, however, for military service or certain other approved periods of unpaid leave after which the employer has agreed in writing to reinstate the employee. Similar exceptions are made to the requirement that employees must have worked 1,250 hours in order to be eligible.

Serious Health Condition

Despite numerous requests from employers and health care providers to clarify the definition of a serious health condition, the DOL made very few revisions to this area of the regulations. Currently, the regulations provide for leave in connection with a period of incapacity of more than three consecutive calendar days so long as the employee or family member has either: (1) one visit to a health care provider plus continuing treatment, or (2) two visits to a health care provider. The proposed regulations clarify that the two visits to a health care provider must occur within 30 days of the beginning of the period of incapacity unless extenuating circumstances exist.

The current regulations also allow for leave in the event of a chronic serious health condition. The proposed regulations specify that in order for a condition to qualify under this definition, it must require at least two or more periodic visits to a health care provider for treatment each year.

Waiver of Rights

The FMLA specifically prevents employees from waiving their rights under the statute. Under the current regulations, confusion developed among the courts over whether this prohibition only covered prospective waivers or also included retroactive waivers, such as those contained in settlement and severance agreements. The proposed

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and software....You may purchase items meeting our specifications from any source."

If the specification was for a proprietary system available only from Domino's, did that practice violate the express language of the Franchise Agreement? Was Domino's effectively compelled to license third parties to offer a system meeting its specifications, or to publish the specification and allow third parties to create systems that met the specification?

The District Court answered those questions in the negative for Domino's. In a major reversal that has silenced the lawyers for the franchisees, the U.S. Court of Appeals for the Eighth Circuit has reversed the District Court, holding that the plain language of the Domino's franchise agreements did not prevent Domino's from designating a single acceptable computer system, even if the system was available only from Domino's or a franchisee selling a used system. (*Bores, et al. v. Domino's Pizza, LLC*, Case 07-2520, June 20, 2008). The appeals court used the dictionary as a means of interpretation, and largely ignored other sources of information on what the parties intended.

We suggest that careful drafting of the technology and sourcing provisions of a franchise agreement can avoid these fights over a franchise's life span. Proprietary technology has always been a part of franchising and a point of difference from competitors for retail customers and franchisees. Only three things in life are certain: the passing of mortals, taxes and technological change. Good planning helps deal with the last two of these certainties.

Mr. Buckberg is an attorney in our Nashville office and is editor of Hospitalitas.

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regulations clarify that while employees may not prospectively waive their rights under the FMLA, they are permitted to waive the FMLA rights retroactively with or without the approval of the courts or the DOL.

Employer Notice to Employees

Under the current regulations, employers are required to designate leave as the FMLA-qualifying within two business days absent extenuating circumstances. The proposed regulations extend this period and require that employers notify employees whether a planned leave will be the FMLA-qualified within five business days of learning of the employee's potential the FMLA-qualifying condition.

The DOL proposes that this notice to employees include eligibility information, employee responsibilities and the consequences to an employee in the event of non-compliance. Additionally, if a planned leave is found to be non-qualifying, the employer must explain why in the notice. To assist in implementing these changes, the DOL has further proposed a new prototype notice form.

Finally, following the United States Supreme Court's decision in *Ragsdale v. Wolverine Worldwide, Inc.*, the proposed regulations clarify that employers may retroactively designate leave as the FMLA-qualifying provided doing so does not cause harm or injury to the employee.

Employee Notice to Employers

Existing regulations provide that an employee does not need to mention the FMLA specifically in order to invoke its protection. In response to comments from employers, the proposed regulations do, however, require employees to provide specific information to employers before the employer's the FMLA responsibilities are triggered. Specifically, the proposed regulations provide that an employee's notice of leave should include: (a) some indication that a condition renders the employee or family member unable to work; (b) an estimated duration of the absence; and (c) whether the employee or family member plans to visit a health care provider. Moreover, the proposed regulations clearly provide that an employee cannot trigger the employer's obligations to further investigate whether an absence is the FMLA-qualifying simply by calling in sick.

The proposed regulations further provide that employees must respond to inquiries by their employers for the purpose of determining whether an absence is the FMLA-qualifying. If they do not, denial of the FMLA leave is appropriate.

Medical Certifications

The proposed regulations clarify that "sufficient medical facts" to support the existence of a serious health condition may include information about symptoms, hospitalization, doctors' visits, prescription medication, referrals for evaluation or treatment or any other regimen of continuing treatment. Additionally, the proposed regulations clarify that health care providers may provide information on the diagnosis of the patient's health condition but are not required to do so in order to complete the certification form. In an attempt to streamline the medical certification process, the DOL has also proposed a new medical certification form.

Contact with Health Care Providers

Current regulations generally prohibit contact between employers and health care providers. The proposed regulations, however, create an exception which permits employers to contact physicians directly if "an employee's serious health condition may also be a disability within the meaning of the Americans with Disabilities Act (ADA)." Employers choosing to avail themselves of this exception, however, must be mindful to follow the additional restrictions imposed by the ADA. An employer may also contact an employee's health care provider to seek "clarification and authentication" of medical certifications.

Fitness for Duty Certifications

In response to numerous comments from employers, the proposed regulations remove the provision that a fitness-for-duty certification must only be a "simple statement." In its place, the DOL proposes to reinsert the original statutory standard requiring the employee to submit a certification from her health care provider stating that she is able to resume work. To further allay safety concerns, employers are permitted to provide employees with a list of their essential job duties. This list must be provided along with the eligibility notice and must be accompanied by notification to employees that a fitness-for-duty certification is required. If such a list of essential functions is provided, the employer is permitted to require the employee's health care provider to certify that the employee can perform each individual duty on the list before allowing the employee to return to work.

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Franchise Agreements in Bankruptcy: Fiasco or Fortuity, *continued*

nated before a bankruptcy is filed. The filing of a bankruptcy does not breathe new life into an agreement in which the debtor already lost his contractual rights prior to the case being filed. Likewise, these rules do not apply to an agreement entered into with a debtor-in-possession after a case is filed.

In general, the Bankruptcy Code gives the debtor (or trustee if one has been appointed) in a Chapter 11 case the right to assume or reject an executory contract such as a franchise agreement. The debtor also has certain rights to assign an executory contract which has been assumed. The debtor's assumption or rejection is subject to court approval except where there is an expiration of the time given to assume, in which event it is automatically deemed to be rejected.

The debtor must assume or reject a franchise agreement as to the whole agreement; the debtor cannot pick and chose the parts he wants to keep and those he wants to drop. What constitutes a "whole" agreement is not always determined by the structure or arrangement of the documents evidencing the agreement. Where several documents are all part of one transaction, one dependent on the other, and linked together by the nature of transaction, they will likely be considered a single agreement, the parts of which must all be assumed or all rejected. The determination of what constitutes a single executory contract or several separate ones will be governed by applicable state law, though the bankruptcy court will decide the issue. For example, where a franchisee enters into a franchise agreement and in conjunction therewith also enters into a software license agreement at the same time, those two documents, even though signed separately, will likely be deemed a single executory contract such that the debtor must assume both or reject both.

The time for the debtor assuming an executory contract and the conditions to be met by the debtor are not unlimited. In a Chapter 7, if the trustee has not assumed the executory contract within 60 days of the filing of the case, the contract is deemed to have been rejected. The trustee can ask the court to extend this deadline. In a Chapter 11, the debtor (or the trustee if one has been appointed) has until confirmation of the plan to assume or reject an executory contract. Often, the plan itself will provide for either assumption or rejection.

Since the time between filing of the case and confirmation of a Chapter 11 plan is many months, if not years, the non-debtor party to the executory contract can file a motion with the court asking that the debtor or trustee be compelled to assume or reject the executory contract. Where a case has been pending for a long time, especially where there is no immediate prospect for confirmation of a plan, the court is more inclined to compel the debtor to decide whether to assume or reject an executory contract. Although a Chapter 11 debtor should be paying all on-going charges incurred in the operation of its business after the case is filed, the court will also be more likely to compel a decision when the debtor is not staying current on the charges incurred under the agreement since the case was filed.

If the debtor or trustee assumes an executory contract, the Bankruptcy Code requires that the debtor: (a) cure defaults or provides adequate assurance that the defaults will be cured; (b) compensate the other party for pecuniary loss or provide adequate assurance of the same; and (c) provide adequate assurance of future performance on the contract. The debtor must cure all defaults, including the prepetition payment defaults, and any on-going operational defaults. Defaults (not including payment defaults) which are impossible to perform do not have to be cured. What constitutes adequate assurance of future performance is judged in commercial terms based on analysis of the facts. This assurance relates not only to the ability to make future payments but also the ability of the debtor to perform in other respects in compliance with the contract being assumed.

In general, a debtor who can properly assume an executory contract has the right to assign it to another party. This most commonly comes up in the context of a debtor selling its business. In cases where the debtor intends to sell its hotel, the debtor will move the court to allow it to assume the franchise agreement so the debtor can assign its rights in the franchise agreement to the purchaser. An executory contract can be assigned to the extent that it is otherwise assignable under applicable law. A recitation in the contract that it cannot be assigned is not necessarily sufficient to bar assignment. Still, the debtor does not have an unfettered right to assign any executory contract.

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Where unique characteristics or qualifications of the debtor were part of the consideration for the contract, assignment may be barred. For example, a contract for an entertainer to perform a show would likely not be assignable since the contract would have been based on the individual talent of the debtor. In cases where a hotel debtor has sought to assume a franchise agreement and assign it to a purchaser, it can be argued that they are not assignable because the decision to grant the rights to the debtor was based not just on the ability to perform financially but on the skill of the debtor in operating and managing a hotel. The purchaser should go through the application, screening and training process before being granted the license rather than being allowed to step into the shoes of the debtor.

If a franchise agreement is not expressly assumed, it is deemed rejected, and the franchisor has a general unsecured claim against the estate for damages. The Bankruptcy Code provides that the rejection constitutes a breach of the contract which is deemed to have occurred immediately before the filing of the petition. By rejecting the agreement, the trustee or debtor forgoes the benefits of performance by the other party but avoids the burden of performance by the estate. While the charges which accrued after the case was filed are in this context part of the prepetition claim, to the extent that the contract benefited the estate after the case was filed, a claim can also be made for payment of the charges incurred during the case as an administrative expense to be paid in full and on a higher priority than payments to general unsecured creditors.

Where the debtor wishes to keep the franchise agreement either for continued operations of its own or for the purposes of assigning it to a purchaser of the property, the debtor will be compelled to assume the agreement. This will obligate the debtor to cure all defaults, even those that occurred prior to the filing of the bankruptcy. It will also require the debtor to demonstrate its ability to perform under the agreement going forward. With assumption of the franchise agreement, the franchisor is given the full benefit of its agreement.

Where the debtor rejects the franchise agreement, the prospects for compensation are not bright. The franchisor will have a general unsecured claim against the estate; however, such claims are often paid pennies on the dollar or nothing at all. Thus, the means of recovery where a debtor rejects the franchise agreement are very limited.

In the event either of assumption or ultimate rejection, understanding and enforcing the duties and obligations of the debtor at the outset of the case can help not only in gaining compensation in the short term but also in speeding a determination of whether there will be a the future in the franchise with the debtor.

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