

## HOSPITALITAS

News and Views for Your Hospitality and Franchise Business



Winter 2017

This is an advertisement.

## 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.

## IS ANDREW PUZDER THE KNIGHT IN SHINING ARMOR FOR THE HOSPITALITY INDUSTRY?

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The hospitality industry has arguably endured the most significant impact from the Obama Administration's employment legislation and regulation. From the Affordable Care Act to overtime expansion, to the attacks on the franchise business model, the hospitality industry (particularly franchised businesses) has spent the last eight years scrambling to address the ever-growing labor regulatory quagmire. When President Donald Trump announced his choice for Secretary of Labor, fast-food executive Andrew Puzder, employers everywhere saw a beacon of hope that some relief from the regulatory stronghold would be forthcoming. Puzder is the

CEO of CKE Restaurants, the California-based (soon Tennessee-based) parent of Carl's Jr. and Hardee's, and an outspoken critic of the Obama Administration's labor policies.

Puzder, a former Midwestern lawyer, became president and CEO of CKE Restaurants in 2000 when the company was nearly bankrupt, burdened by more than \$700 million in debt and a market capitalization that had fallen to approximately \$200,000. Puzder rebuilt the Hardee's and Carl's Jr. brands into an empire. Under Puzder's leadership, CKE Restaurants now has 3,750 restaurants worldwide, employs approximately 100,000 employees (75,000 in the U.S.) and generates more than \$4.3 billion in revenue. Trump highlighted Puzder's work experience as beneficial for his new role leading the Department of Labor, saying, "Andy will fight to make American workers safer and more prosperous by enforcing fair occupational safety standards and

## IS ANDREW PUZDER THE KNIGHT IN SHINING ARMOR FOR THE HOSPITALITY INDUSTRY?, *continued*

ensuring workers receive the benefits they deserve, and he will save small businesses from the crushing burdens of unnecessary regulations that are stunting job growth and suppressing wages.”

Puzder’s nomination, however, is not without controversy. He is and has been an outspoken critic of the Obama Administration labor policies. In a *Forbes* op-ed piece that was published shortly after the announcement of the new overtime rule, Puzder wrote that the new regulations would “simply add to the extensive regulatory maze the Obama Administration has imposed on employers.” He opposes an increase in the minimum wage beyond \$9/hour, supports deregulation and is a strong opponent of the Affordable Care Act. Puzder’s opponents, both labor groups and Democrats, have come out in full force and are trying to make an issue of his record as the CEO of CKE Restaurants. Senators Patty Murray, D-Wash., and Elizabeth Warren, D-Mass., held a press conference January 10 criticizing Puzder for alleged violations of wage and hour, safety and equal employment opportunity laws at Carl’s Jr. and Hardee’s (mostly franchise) restaurants. The Restaurant Opportunities Centers United, an advocacy group for restaurant employees, released a survey of CKE workers, many of whom accused the chain of labor law violations. Two-thirds of women in the survey said they had been sexually harassed on the job. But in a battle of surveys,

the Employment Policies Institute released another survey the same day that found that employees of Hardee’s and Carl’s Jr. franchises were overwhelmingly satisfied with their work environment.

Puzder has yet to be confirmed as Labor Secretary. His hearing, which was scheduled for January 17, was postponed by the Senate leadership and will likely not be rescheduled until February. News organizations recently reported that Puzder was having second thoughts about serving due to the weight of the scrutiny and criticism he is receiving. Shortly after the “second thought” stories were published, however, Puzder wrote a simple tweet stating, “I am looking forward to my hearing.” Almost two dozen Senate Democrats are calling for Hardee’s and Carl Jr.’s fast-food workers to testify at Puzder’s confirmation hearing. A nominee is confirmed, however, with a simple majority of 51 votes and Republicans hold a 52-to-48 majority in the Senate. Therefore, it seems unlikely that Democrats will be able to actually block Puzder’s appointment. They can, however, certainly prolong the process and make it more difficult. Between Inauguration Day and Puzder’s Senate confirmation, the cabinet position will essentially be rendered empty. Puzder’s opponents and proponents will just have to wait a little longer to see what actions he will take once he is in office.

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## REGULATION A+: A CAPITAL-RISING METHOD THAT IS READY FOR FRANCHISING

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In a [prior article](#) published in *Franchising Today*, we addressed the intersection of franchises and crowdfunding, a method of business financing which was made legal through rulemaking on the part of the Securities and Exchange Commission (SEC)

as part of the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). This article will focus on another provision in the JOBS Act, often called Regulation A+ (Reg A+). The provision is called Reg A+ because it is an expansion of an older, under-used securities selling procedure called Regulation A.

## REGULATION A+: A CAPITAL-RISING METHOD THAT IS READY FOR FRANCHISING, *continued*



Reg A+ allows companies to raise up to \$50 million per year from the public. As the SEC designed Reg A+ to provide necessary capital to developing

businesses, such as growing franchise concepts, Reg A+ generally translates into a method that is much cheaper than conducting a traditional initial public offering (or IPO) of securities. With the assistance of expert counsel, a Reg A+ offering is potentially not much more expensive than an equity crowdfunding offering. Also, unlike a crowdfunding offering, a Reg A+ offering need not be conducted through a third party platform, and instead, can be generally solicited directly to the public by the franchisor or franchisee.

### Preparing to Use Reg A+

Franchisors are already subject to rigorous disclosure requirements under the Franchise Rule promulgated by the Federal Trade Commission and certain other state franchise laws. Much of the disclosure required to be included in a Reg A+ offering circular is already encompassed in a franchise disclosure document (FDD), so franchisors have already prepared much of the disclosure required to be filed with the SEC. From the franchisee side, the information in the franchisor's FDD provides some of the information necessary to meet Reg A+'s disclosure standards, or at least provides the basis for developing the necessary information to satisfy Reg A+'s requirements.

Does this mean that a franchisor can slap a new cover page sheet on its current FDD and be ready to file its Reg A+ offering circular with the SEC? No, but with a modest amount of effort on the parts of the franchisor, counsel and in certain cases, the franchisor's auditors, to describe the corporate governance documents and equity attributes not otherwise covered in the FDD, a franchisor can quickly be compliant with Reg A+'s offering circular requirements, allowing the franchisor to file the offering circular with the SEC to launch its securities offering.

Although the disclosures required in a Reg A+ offering circular (and SEC Form 1-A, which is the form filed with the SEC along with the offering circular) and FDDs are quite similar, franchisors and franchisees new to SEC reporting should be prepared to spend additional resources on securities law compliance. However, the costs of such securities law compliance are likely much smaller for a franchisor or franchisee, as compared to an issuer not engaged in franchising. By leveraging its compliance resource allocation for simultaneous franchising and securities law compliance, a franchisor or franchisee can "kill two birds with one stone." The obligation to file Form 8-K and the obligation to amend the FDD for material changes are likely consequences of the same significant event. An audit is an audit, and the skills and reporting for one area are not dissimilar to the other, such that an audit conducted for franchising purposes can just as easily be used for securities law compliance.

To help franchisors and franchisees understand the landscape of SEC compliance, a short discussion of the legal nuts and bolts of Reg A+ follows.

### Legal Nuts and Bolts

Reg A+ is divided into two tiers. Tier 1 allows a company to raise up to \$20 million, but does not pre-empt state level (or "blue sky") registration requirements. For this reason, it is unlikely that many issuers will utilize Tier 1, as the cost and time burden of effectively conducting separate securities offerings in each state of the union is likely to be economically and temporally inefficient.

Tier 2 of Reg A+ allows a company to raise up to \$50 million per year and the offering is exempt from state blue sky registration and qualifications. However, Tier 2 issuers must provide two years of audited financials, whereas the financials included in Tier 1 issuers' offering circulars need not be audited. The other key difference between the tiers of Reg A+ is that Tier 2 issuers must file semi-annual reports and material event reports with the SEC until the offering is terminated, while Tier 1 issuers are only required to file reports upon the commencement of an offering, termination of the offering or when a material change to the offering has occurred.

## REGULATION A+: A CAPITAL-RISING METHOD THAT IS READY FOR FRANCHISING, *continued*



The securities issued under both Tiers 1 and 2 are unrestricted and freely transferable, meaning that the issuer's securities are available for immediate secondary trading and can

be listed on Nasdaq or the New York Stock Exchange (NYSE), or quoted on the OTC Markets Group Inc.'s marketplaces such as the OTCQX and Pink Sheets. The audit requirement is consistent with the FTC's approach to start up franchisor audit requirements in Item 21 of the FDD. However, many registration states require the opening day balance sheet of a franchisor to be audited as a condition to obtain registration.

To assist in creating liquidity for non-insider shareholders, secondary sales by issuer affiliates (such as officers and directors of the issuer) during the first year after the commencement of an issuer's initial Reg A+ offering cannot account for more than 30 percent of the total dollar amount of securities offered for sale in the offering.

### Franchisees as the Franchisor's Stockholders

How often does a franchisee ask whether he or she can invest in the franchisor? Reg A+ offers franchisors the opportunity to consider paired or paperclip offerings, where the prospective franchisee is also offered the opportunity to invest in the franchisor's equity. Existing franchisees that are successful and committed to the success of the franchise concept may offer another pool of potential investors in a franchisor's Reg A+ offering. Communication vehicles between a franchisor and its franchisees also offer the opportunity to promote the offering to a group of potential investors without the need for any general solicitation.

If such franchisees are accredited investors, there is no dollar amount limit to the number of securities franchisor can sell, up to the \$50 million limit under Reg A+, Tier 2. Broadly, in the United States, to be considered an accredited investor, one must have a net worth of at least \$1 million, excluding the value of one's primary residence, or have income at least \$200,000 each year for the last two years (or \$300,000 combined income if married).

For Reg A+ issuers that do not list their securities on Nasdaq or the NYSE under Reg A+, Tier 2 Investments by individual, unaccredited investors cannot exceed either: (a) ten percent of the investor's annual income; or (b) ten percent of the investor's net worth, whichever is the greater number. Tier 1 offerings do not have such limitations, beyond the \$20 million cap imposed on Tier 1 offerings. For entities investing in Tier 2 offerings, investments must not exceed the new Regulation A+ limitation of either: (a) ten percent of the investor's annual revenue at the last fiscal year-end; or (b) ten percent of the investor's net worth at fiscal year-end, whichever is the greater amount.

### Conclusion

Using Reg A+ to raise money from franchisees is just one example of the utility of Reg A+ for franchisors. Franchisees may also use Reg A+ to finance improvements to their existing locations, purchases of new locations or even purchases of real estate upon which to build new locations. The financing possibilities are legion when harnessing the ability to raise money by soliciting the general public for investment. Best of all, Reg A+ offerings in the franchising context are particularly attractive as administrative efficiency opportunities can be exploited to minimize legal costs and the economic burden of compliance already inherent in franchising, thereby maximizing franchise revenues.

## THE (SOMETIMES UNETHICAL) REALITY OF COMPETITION AND YOUR AMMO TO COMBAT A RIVAL'S FALSE ADVERTISING

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### I. Introduction

Competition in the free-market economy is cutthroat and businesses seek to gain a slight edge over their competitors however they can. In

an effort to gain such an advantage, these businesses may spread falsehoods about the quality of their rivals' products or services. Though a business suffering from a competitor's false advertising may take the non-litigious "high road" as long as possible, this scenario can reach a point where it causes a business to lose customers or, even worse, its business reputation in the community is permanently damaged. Accordingly, the question remains: what can a business do in the event a competitor lies about its product or services? After the United States District Court for the Southern District of California decided [\*CrossFit, Inc. v. National Strength and Conditioning Association\*](#) in the fall of 2016, suffering businesses finally have some guidance.

### II. What Did the Court Say?

By way of background, CrossFit, Inc. filed a lawsuit against the National Strength and Conditioning Association (NSCA) on May 12, 2014, alleging false advertising and unfair competition in the aftermath of the November 2013 publication of the NSCA's article "CrossFit-based high-intensity power training improves maximal aerobic fitness and body composition," which was published in the *Journal of Strength and Conditioning Research*. The article stated, "[i]n spite of a deliberate periodization and supervision of our CrossFit [sic]-based training program by certified fitness professionals, a notable percentage of our subjects (16%) did not complete the training program and return for follow-up testing." The NSCA also noted CrossFit's "injury rate" and emphasized its conclusion that CrossFit's training regimen caused injuries to that 16 percent of test subjects. The parties ultimately filed dueling motions for summary judgment.

The court issued a ruling granting CrossFit's motion for summary judgment on the basis of falsity, holding that the NSCA's publication that CrossFit's fitness program had a high rate of injury was unsupported by the data and false "regardless of whether the authors knew it at the time." In other words, a federal judge recognized falsity in a publication as a matter of legal fact. In so holding, Judge Sammartino stated, "[a] reasonable fact finder could conclude that the NSCA fabricated the injury data...with the intention of protecting its market share in the fitness industry."<sup>1</sup>

Notably, the court rejected the NSCA's First Amendment argument that scientific journals have the right to publish false or unsupported information about commercial competitors without facing false advertising charges. Indeed, Judge Sammartino reasoned, "[i]f a party intentionally publishes false data about a competitor's product to protect its own market share, that speech is commercial in nature and not subject to the same degree of protection as noncommercial speech."

### III. So What Now?

Imagine, for a moment, a world where the NSCA had prevailed. Burger King could publish that McDonald's hamburgers cause humans to spontaneously combust, and McDonald's could not retaliate with a lawsuit for false advertising.

Thankfully, a business suffering from a competitor's false advertising can file a lawsuit against the competitor and, under the holding in *CrossFit*, survive summary judgment and advance its claims to the fact finder for a determination on damages. Competing businesses spreading false advertising must be held accountable for their statements and publications, and they cannot hide behind the First Amendment if their publication was "commercial" in nature.

<sup>1</sup> As of this writing, the NSCA is currently seeking for the court to certify its order so that it can appeal the ruling.

## THE (SOMETIMES UNETHICAL) REALITY OF COMPETITION AND YOUR AMMO TO COMBAT A RIVAL'S FALSE ADVERTISING, *continued*

### IV. What Do You Need to Prove to Succeed in a Suit for False Advertising?

To succeed in a lawsuit for false advertising, a plaintiff would need to establish:

- **Falsity.** That is, that the competitor's statement "was literally false, either on its face or by necessary implication, or that the statement was literally true but likely to mislead or confuse consumers";
- That the competitor **intended** to publish the false information – for example, in *CrossFit*, CrossFit established that the NCSA's editor-in-chief pressured the authors to include the injury data in their study;
- That the competitor's publication was **economically-motivated and commercial in nature** in order to defeat the competitor's inevitable First Amendment defense; and
- **Damages.** That is, that the erroneous data in the competitor's publication hurt your brand financially through lost customers, sales or damage to your business's reputation.

### V. What Action Can You Take?

As you achieve success, your business may face competitors' false advertising and combatting it is not easy or for the faint of heart. First, make sure the advertising actually originates from a competitor and is not simply a misunderstanding. If the competitor is indeed trying to discredit you or steal your business, it may be time to step into the ring and file suit. As you know, your customer loyalty and business reputation are incredibly important, especially if your brand is already a recognized authority in your industry. Accordingly, don't hesitate to seek legal assistance to help you maneuver through the complex legal requirements of stating a claim and succeeding in your lawsuit. Take a page out of CrossFit's book and don't accept a competing business's bullying and lies.

For any questions about filing such a suit or protecting your business's brand, please contact the author or any member of Baker Donelson's Hospitality and Distribution Service Team.

## SBA CHANGES THE GAME

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On November 22, 2016, the Small Business Administration released SOP 50 10 5(I) (the "SOP"), which is administrative speak for new standard operating procedures affecting loans to businesses involved in franchising. The well-trodden paths to franchise lending using the Franchise Registry and the forms of SBA Addenda to franchise agreements worked out by franchisors were largely obliterated with the figurative stroke of a pen. The franchise world was taken by surprise and now must adjust its thinking and procedures, effective with SBA loan applications submitted on and after January 1, 2017. The goal was to provide guidance on what was and wasn't affiliation between the franchisee and its franchisor. Here's what the changes mean and how the world of SBA financing will be reset:

- The SBA has a standard form addendum to franchise agreements that must be signed verbatim by the franchisor and the franchisee. The language is substantially the same as the form demanded by the SBA for several years, but the negotiated nuances of individual franchisors will disappear.
- The SBA will not review franchise and license agreements for provisions that constitute "affiliation" or excessive control of franchisee decision-making by the franchisor.
- The SBA will discontinue the separate lists of franchises that either do or don't create relationships that constitute affiliation. This ends the Franchise Registry and the SBA Franchise Findings List.
- The SBA imports the definition of a franchise from the Federal Trade Commission Franchise Rule, 16 CFR Part 436.1(h) and the related commentary and guidance to determine what qualifies as a franchise for purposes of the SOP. Franchises governed by the Petroleum Marketing Practices Act and exempt from FTC Franchise Rule disclosure are covered by the SOP.

## SBA CHANGES THE GAME, *continued*

- The SBA loan eligibility criteria are limited to applicants that are independently owned and operated small businesses and not dominant in their field of operation, with the right to profit from their efforts and bear the risk of loss commensurate with ownership. There are no interpretations or metrics that accompany this language.
- The SBA will not finance master franchise or development agreements that do not grant the franchisee/developer the right to develop outlets because they are passive investments and/or inherently speculative. However, area development agreements that contemplate the outlet development and operation will be eligible for financing.
- In a nod to political correctness, the SBA will no longer finance businesses that restrict patronage on any basis other than capacity. That means gender-restricted businesses such as single sex health clubs and fitness centers cannot be financed.
- Although couched in terms of collateral evaluation, the efforts of franchisors to use real estate covenants, subordinations and other indirect property controls that effectively limit the use of SBA-financed assets to a single use or franchise system will be prohibited for SBA financing. Property must be capable of being sold without restriction.
- The simplified SBA Addendum requires that the franchisor (i) not unreasonably withhold consent to transfer, (ii) not exercise a right of first refusal for transfers involving existing owners, (iii) not hold the right to purchase real estate owned by the franchisee (a lease for the balance of the franchise term at market rent is permitted), (iv) not restrict post-franchise use of the franchise site owned by the franchisee, and (v) not directly control (hire, fire, schedule) franchisee employees. Simple, right?

Will the new SBA Administrator nominee, Linda McMahon, reverse or change this SOP if she is confirmed? No indication has been published at this writing. Will this approach simplify borrowing for franchisee borrowers? Yes, most likely. Will lenders get squeamish about unconventional franchise agreement terms and franchise service programs that reduce franchisee discretion and risk? Yes, most likely. Has the franchise world heard the last word on this SOP? Not likely.

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## VALUE-BASED PRICING OPTIONS FOR FRANCHISE CLIENTS

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Baker Donelson's attorneys routinely collaborate with our clients to develop specific and meaningful alternative pricing models – compensation

options that offer choices beyond the billable hour model and often involve sharing both risks and rewards with our clients. Alternative pricing models can reduce inefficiencies, increase productivity and improve the way we deliver legal services, while better aligning the cost of the engagement and value to the client.

One such model, well-suited to clients in the hospitality industry, is a phased fixed fee proposal that we offer for premises liability cases. This model, constructed as a “menu-style” offering, allows our clients to select the strategy that fits the particular matter at issue, and evaluate the projected spend for the combination of various “phases” or “tranches” that will be executed through the resolution of the matter. A sample of this offering is illustrated below.

The most important lesson we have learned in our experience with alternative fees is that they are truly a collaborative effort between the client and the Firm, particularly with regard to the determination of what type – or types – of model to use.

## VALUE-BASED PRICING OPTIONS FOR FRANCHISE CLIENTS, *continued*

The implementation of any pricing model requires a thorough evaluation of several key factors such as the type of matter, a reliable estimate of the work required, whether the matter involves repetitive or complex issues, the client’s exposure to damages, the client’s philosophy and approach to litigation or particular transactions and the historical cost of similar matters. By working with our clients to more clearly define “success” from the outset of an engagement, we are able to build pricing that focuses on results and outcomes. If there is an interest in this type of phased pricing model, we recommend a meeting between the client and our litigation team to confirm the client’s objectives and strategies and clarify the scope and any limitations of this model.

### Sample Phased Fixed Fee Pricing – Premises Liability Defense

PHASED PRICING PROPOSAL	
Phase One	Initial Case Analysis
Phase Two	Answer/Challenge Pleadings
Phase Three	Initial Discovery
Phase Four	Follow-up/Expert Discovery
Phase Five	Dispositive Motions
Phase Six	Trial Preparation

ADDITIONAL MENU ITEMS
Trial (Per Day)
Mediation/Settlement Conference
Each Expert Retained Over Two
Each Deposition Taken Over Two
Each Deposition Defended Over Two

## BAKER DONELSON/OBER|KALER MERGER COMPLETE



Baker Donelson and Ober|Kaler have completed their previously announced combination, resulting in one of the 50 largest law firms in the country. The

combined firm, which maintains the name of Baker Donelson, boasts more than 800 attorneys and advisors across 25 offices in ten states as well as Washington, D.C.

Joining from Ober|Kaler were nearly 110 attorneys and more than 100 staff members, giving the combined firm more than 800 attorneys and advisors, including around 380 shareholders and nearly 1,600 total employees.

The combination of Baker Donelson with Baltimore-based Ober|Kaler also results in the third largest health practice in the country. The combined practice, now known as Baker Ober Health Law, has nearly 200 attorneys, including some of the most prominent leaders in the field of health law. The merger also gives Baker Donelson a strong presence in three crucial markets that drive the nation’s health care industry: Baltimore, which is home to the headquarters of the Centers for Medicare & Medicaid Services; Washington, D.C., the center for health policy and regulation; and Nashville, the nation’s center for for-profit health care.

The combination has also created a predominant financial services practice, joining Ober|Kaler’s strengths in commercial finance and representation of community banking institutions with Baker Donelson’s reputation as a leader in regulatory, transactional and litigation matters for financial institutions. Among other practices that are enhanced by the combination are construction, litigation, tax and intellectual property.



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Winter 2017

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## SARA TURNER APPOINTED VICE CHAIR OF DEFENSE RESEARCH INSTITUTE RETAIL AND HOSPITALITY COMMITTEE



Sara Turner, a shareholder in Baker Donelson's Birmingham office and co-chair of Baker Donelson's Hospitality Industry Service Team, has been appointed to a one-year term as vice chair of the Defense Research Institute (DRI)

Retail and Hospitality Committee.

The DRI is an organization of defense attorneys and in-house counsel dedicated to providing access to resources for attorneys who strive to provide high-quality, balanced and excellent service to their clients and corporations. The Retail and Hospitality Committee provides legal education, professional development and networking opportunities specific to the DRI members involved in the retail and hospitality industries.

Ms. Turner's trial experience includes product liability, drug and medical device, hospitality, timeshare, complex commercial litigation, class action and franchise claims. She has previously served as chair of the DRI's Technology Committee. Ms. Turner has been recognized in Alabama Super Lawyers since 2011 and has been recognized as one of *Birmingham Business Journal's* "Top 40 Under 40" in 2013 and as one of "Birmingham's Top Women Lawyers" by *B-Metro* magazine in 2016.

## BAKER DONELSON WILL BE AT IFA BOOTH 607



If you'll be attending the International Franchise Conference in Las Vegas next month, come by booth 607 to say hello and get a sweet treat from Nashville.

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