

# HOTEL yearbook 2012

Scenarios for the year ahead

Choice CEO Stephen Joyce :  
Ideas, insights – and wishes – for 2012

Is your hotel ready for the Chinese?

The 2012 outlook for key hotel markets :  
30 exclusive country reports from Horwath HTL

Next year's IT challenges :  
What will they be? How much will they cost?

Legal issues facing us in Europe, China and the USA

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## **ECOLE HÔTELIÈRE DE LAUSANNE**

The Ecole hôtelière de Lausanne (EHL) is the co-publisher of The Hotel Yearbook. As the oldest Hotel School in the world, EHL provides university education to students with talent and ambition, who are aiming for careers at the forefront of the international hospitality industry. Dedicated to preparing tomorrow's executives to the highest possible level, EHL regularly adapts the contents of its three academic programs to reflect the latest technologies and trends in the marketplace. Since its founding in 1893, the Ecole hôtelière de Lausanne has developed more than 25'000 executives for the hospitality industry, providing it today with an invaluable network of contacts for all the members of the EHL community. Some 1'800 students from over 90 different countries are currently enjoying the unique and enriching environment of the Ecole hôtelière de Lausanne.



## **HORWATH HTL**

Horwath Hotel, Tourism and Leisure consulting are the world's number one hospitality consulting organisation, operating since 1915. Horwath HTL are the industry choice; a global network offering complete solutions in markets both local and international. Through involvement in thousands of projects over many years, Horwath HTL have amassed extensive, in-depth knowledge and understanding of the needs of hotel & real estate companies and financial institutions.

Horwath HTL are the world's largest consulting organisation specialised in the hospitality industry, with 50 offices in 39 countries. They are recognised as the pre-eminent specialist in Hotels, Tourism and Leisure, providing solutions through a combination of international experience and expert local knowledge.



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With an exclusive focus on global hospitality and tourism, Hsyndicate.org (the Hospitality Syndicate) provides electronic news publication, syndication and distribution on behalf of some 750 organizations in the hospitality vertical. Hsyndicate helps its members to reach highly targeted audience-segments in the exploding new-media landscape within hospitality. With the central idea 'ONE Industry, ONE Network', Hsyndicate merges historically fragmented industry intelligence into a single online information and knowledge resource serving the information-needs of targeted audience-groups throughout the hospitality, travel & tourism industries... serving professionals relying on Hsyndicate's specific and context-relevant intelligence delivered to them when they need it and how they need it.



## **CORNELL UNIVERSITY SCHOOL OF HOTEL ADMINISTRATION**

Founded in 1922, Cornell University's School of Hotel Administration was the first collegiate program in hospitality management. Today it is regarded as one of the world's leaders in its field. The school's highly talented and motivated students learn from 60 full-time faculty members – all experts in their chosen disciplines, and all dedicated to teaching, research and service. Learning takes place in state-of-the-art classrooms, in the on-campus Statler hotel, and in varied industry settings around the world. The result: a supremely accomplished alumni group-corporate executives and entrepreneurs who advance the industry and share their wisdom and experience with our students and faculty.

# Aiming for more agreeable agreements

IN THE CURRENT ECONOMIC ENVIRONMENT, CHALLENGING SCENARIOS LIE AHEAD FOR THE US HOTEL INDUSTRY. INCREASED FINANCIAL UNCERTAINTIES MEAN THAT CERTAIN LEGAL ISSUES RELATED TO THE RELATIONSHIP BETWEEN OWNERS AND DEVELOPERS, ASSET MANAGERS AND OPERATORS WILL COME INTO SHARPER FOCUS IN 2012. **LETVIA M. ARZA-GODERICH** AND **SCOTT A. PRESTON**, OF LOS ANGELES BASED **PRESTON ARZA LLP**, SHARE THEIR OUTLOOK FOR THE COMING YEAR.

We are all facing unsettling challenges due to the global financial and economic realities, and the hotel industry is no exception. Financing constitutes a frequent obstacle, and in that regard, developers, owners, asset managers and operators are dealing with the element of risk in a more poignant fashion. Thus, when documenting contractual relationships and transactions involving hotels, this poignancy must be addressed. In the spirit of sharing some helpful insight, we offer the following commentary on certain legal issues,

concerns and developments of significance for the various players in the hotel industry.

## **THE MANAGEMENT AGREEMENT: ROADMAP TO THE FUTURE?**

In the branded hotel industry, there is a clear trend towards a business model based on the branding operator not owning the hotel assets, but instead operating the hotel as an agent of the hotel owner, pursuant to a long-term, renewable management agreement that ordinarily comprises complex and



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detailed terms and conditions reflecting industry standards. Key provisions of hotel management agreements include, *without limitation*, the term (duration) and conditions for renewal, the manner in which an operator's management fee is calculated and paid, what portion of such fee corresponds to an *incentive fee* which may be subject to its own specific basis, the obligations of the hotel owner to provide the capital for the maintenance and improvements of the hotel facilities in compliance with the operator's standards, the funding of reserves, the definition of what constitutes default on the part of the hotel operator and the owner, respectively, the rights of each party to cure its default, and the all-important termination rights. Negotiation of a hotel management agreement typically is a protracted process during several months.

## **FAIRMONT V. TURNBERRY: THE POWER TO REVOKE**

The general presumption in the industry has been that the terms of a hotel management agreement defined the «private rule of law» between the parties. That may have been the case until the recent, eyebrow-raising case of *FHR TB, LLC, et al. v. TB ISLE RESORT, LP*, better known as *Fairmont v. Turnberry*, in the United States District Court for the Southern District of Florida. The case generated much controversy, as it involved the unprecedented «overnight» ouster by the hotel-resort owner (Turnberry) of the manager-operator brand (Fairmont), in blatant disregard of clauses and provisions in the management agreement that required prior notice of default, right and opportunity to cure and other typical provisions with respect to termination.

Fairmont filed a request for injunction, claiming that it had the contractual right to have its management team reinstated by order of the court. Turnberry countered with a very basic argument under the parties' chosen law of New York; in brief, Turnberry relied on the fundamental «agency» nature of the relationship between manager (as agent) and owner (as principal), and the owner-principal's *power* to revoke such an agency relationship at will (subject to the agent-manager's claim for damages as a result of such premature termination). To the surprise of many, Turnberry prevailed, and Fairmont was

denied injunctive relief. The well-reasoned and impartial analysis of the magistrate, adopted by the court, should be mandatory reading for anyone involved in the negotiation and drafting of a management agreement between a branded operator and an owner. Enjoy a memorable quote from the opinion summarizing the general rule of law of agency in New York: «[T]he principal has the *power* to revoke the agency even if that revocation is wrong, even if it breaches the applicable contract and even if the revocation creates a clear-cut liability for damages.»

The opinion alluded to the one exception to the rule of revocability of an agency: «when the agency is coupled with an interest in the subject of the agency.» However, the case placed a fresh light on the legal concept of «*coupled with an interest*.» We regale you with a second memorable quote from the opinion: «Words alone are not enough to establish an agency coupled with an interest. ... Since [agent] does not have a property interest in [the subject of the agency], its agency is revocable and it was revoked.» The opinion held that Fairmont's right of first offer and right of first refusal in the event that the owner placed the hotel property for sale were contingent, not actual, *immediately vested* rights, and thus did not make the agency one «coupled with an interest.» As is often the case, the devil was in the details.

## **SNDAS (SUBORDINATION, NON-DISTURBANCE AND ATTORNMENT AGREEMENTS)**

We have trouble remembering a time when financing was such an issue in any business area, but particularly in the hotel industry. In such a dire scenario, with lenders demanding stringent loan-to-value requirements and shying away from overleveraged structures, debt service becomes a difficult proposition for many hotel owners. By signing a Subordination, Non-Disturbance and Attornment Agreement («SNDA»), a hotel lender essentially agrees that if said lender seeks a receiver or acquires control of or title to the property through a foreclosure or analogous proceeding, that lender will step into the shoes of the hotel owner's obligations pursuant to the hotel management agreement.

# Aiming for more agreeable agreements

Traditionally (or shall we say « before the crisis »), SNDAs were commonplace, came as part of the management brand's package of forms, and lenders signed them without much pause. Now, lawyers for hotel lenders are advising them to consider the consequences of signing an SNDA very carefully, in view of the possibility that once an SNDA is signed, foreclosure will not cut off that hotel management agreement. In such a case, the hotel property value might be reduced because it is « encumbered » by the obligations under the long-term hotel management agreement. Thus, many lenders have adopted the practice of refusing to sign SNDAs. Given the paucity of financing sources, some brands are caving to the lenders' refusal to sign SNDAs. We should point out that voices of reason from within the industry suggest that a well-negotiated, carefully crafted SNDA may become a vehicle for an orderly transition in a foreclosure or post-foreclosure setting.

## KEY MONEY PROVISIONS

« Key money » is a term referring to a financial contribution by the hotel operator to the hotel construction or conversion, in upscale or large-size projects, and usually not paid until the hotel is about to open or has just opened. Hotel management agreements will ordinarily include the terms with respect to the operator's contribution and owner's repayment of key money. Hotel management agreements often provide what is known in the industry as the key money « burn-off » (a form of amortization or gradual forgiveness of the obligation to repay the key money over initial fifteen- or twenty-year term of the management agreement).

A commonly found provision calls for the immediate repayment of the key money should the management agreement be terminated for any reason. In these challenging times in which occupancy levels have tended to decline, lawyers for hotel owners are advising them to contemplate a scenario where the operator terminates the management agreement and then demands repayment of any unamortized key money from the hotel owner.

One method to seek protection from such a risk is to ascertain that the key money obligations are integrated into the hotel management agreements and, thus, subject to a defense by the

owner on the basis of the operator's breach of its obligations under said management agreement. Cases have been reported in which the key money obligations were in a separate

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agreement, rendering it difficult for the hotel owner to obtain a discharge of key money repayment obligations upon termination by the operator.

## A DISAPPEARING COMPONENT: THE SECOND HOME

An experienced development executive for a prominent international hotel brand recently reminded us of a significant change in the mix of hospitality projects seeking sources of financing or funding: the dwindling market for a vacation or second home.

While many developers insist on including a residential component in their development plans for tourism resorts or larger hospitality projects, the harsh reality appears to be that the market for a second or vacation home has weakened considerably. Exceptions to this trend can be spotted in destinations such as Panama, where the marketers of mixed-use developments including a residential component are targeting a lower-income purchaser by offering a modestly priced alternative. Such a real estate component, however, will not generate significant additional income streams for the hotel, the way it was once projected in the hotel industry. ■



Hotel Marina El Cid Spa and Beach Resort  
Puerto Morelos, México



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We invite you to contact us to discuss your needs.