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INTERNATIONAL HOTEL EXPANSION

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John M. Vernon

AREAS OF PRACTICE

Mr. Vernon advises and counsels clients on cross-border international and domestic transactions, including a full range of acquisition, joint venture, privatization, project financing, foreign investment, trade resolution dispute resolution, dealer/supplier franchising, licensing product distribution transactions, export compliance, customs and international trade, FCPA, FTZs, ITAR, NAFTA, FTAs, economic sanctions, OFA, BIS, EAR, CTPAs, CFTA and “deemed export issues.” He has guided the development of U.S.-based companies’ expansion into Mexico, Latin American, the Middle East, Europe, and the Far East. Conversely, he has guided the development of foreign-based companies’ expansion into the United States and Mexico. He is also an adjunct professor at SMU Law School teaching courses in franchising and distribution law.

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Mr. Vernon is not certified by the Texas Board of Legal Specialization.

PROFESSIONAL/CIVIC ACTIVITIES

- Rated AV in Martindale Hubbell
- Member of Unidroit Committee of Government Experts in Rome, April, 2002, to participate in negotiations of a Model Franchise Disclosure Law
- Member of the International Bar Association (Vice Chair, Committee X)
- Member of the International Franchise Association (Council of Franchise Suppliers)
- Member of the American Arbitration Association Panel of Arbitrators International/Domestic from 1990 – 1998
- Member of the International Commercial Dispute Resolution Committee of ABA Section of International Law and Practice
- Member of The Institute for Transnational Arbitration, a Division of The Center For American And International Law (formerly The Southwestern Legal Foundation)
- Member of the American Bar Association International Section
- Member of the ABA Forum on Franchising
- Member of the State Bar of Texas Intellectual Property Section (International Law and Franchising Committee)
- Member of the Dallas Bar Association (Chair, Equal Access Campaign 2000; Founding Member and Director, Franchise Law Section)
- Member of Federal Bar Association
- Member of the Southwestern Legal Foundation (Board of Advisors)
- Member of the U.S.-Mexico Chamber of Commerce (former Chair, Trade Mission Committee)
- Listed in an International “Who’s Who” of Franchise Lawyers
- Founder, University of Texas School of Law’s annual Expanding Abroad Conference
- Member, University of Texas Millennium Committee
- Member Texas Appleseed and the Appleseed Foundation
- Greenhill School Dallas Building Campaign Committee
- Greenhill School Dallas Annual Giving Campaign (Former Grade Chair)
- Member of Board of Medisend International
- Member of Board of Boys & Girls Clubs of Greater Dallas, Inc.
- Listed in Franchise Times magazine top “Legal Eagle in Franchising”

- Recipient of 2005 Pro Bono Service Award by the Texas Appleseed Foundation
- Member, IBA Section on Business Law
- Member, IBA Asia Pacific Forum
- Member, Latin America/Caribbean Forum
- Former Member State Bar of Texas Unauthorized Practice of Law Committee

COURT ADMISSIONS

- U.S. District Court for the Northern District of Texas
- U.S. District Court for the Southern District of Texas
- U.S. District Court for the Eastern District of Texas
- U.S. District Court for the Western District of Texas
- Texas state courts
- Court of International Trade
- U. S. District Court for Central District of Utah
- Utah state courts

BAR ADMISSIONS

Bar of Texas

Bar of Utah

EDUCATION

J.D., St. Mary's University of San Antonio, 1978

B.A., University of Texas at Austin, 1975

LANGUAGES

Proficient in Spanish

Proficient in Italian

PUBLICATIONS/PRESENTATIONS

Articles

Franchising Opportunities in Central Europe (Part II), *The Enterprise*, by John M. Vernon, December 2005.

Franchising Opportunities in Central Europe (Part I), *The Enterprise*, by John M. Vernon, November 2005.

The Impact of Sarbanes-Oxley on Intellectual Property in a Franchising System, *Franchise Times*, by John M. Vernon, November/December 2005.

Hotel Expansion in Eastern Europe, *The Enterprise*, by John M. Vernon, October 2005.

Structuring Business Expansions Around the Franchise Laws, *Franchise Times*, by John M. Vernon, October 2005.

Fundamental Research and ITAR in the Private Sector, *The Enterprise*, by John M. Vernon, September 2005.

Pony Express or Information Superhighway? New Support For Franchising E-Disclosure, *Franchise Times*, by John M. Vernon, September 2005.

An American Prospective on the Key to Successful Franchising into Europe, *The Enterprise*, by John M. Vernon, July 2005.

Franchising American Style, *Franchise Times*, by John M. Vernon, June/July 2005.

A `Resurgence of American Franchising, *The Enterprise*, by John M. Vernon, June 2005.

Mexican franchising enters the next generation, *Franchise Times*, by John M. Vernon, May 2005.

Establishing A Franchise Export Control Program, *Franchise Times*, by John M. Vernon, March 2005.

Establishing a franchise export control program, *The Enterprise*, by John M. Vernon, February 2005.

FTC Rule Makeover: Part Two: The International Perspective, *The Enterprise*, by John M. Vernon, January 2005.

The Unintended Consequence; *Franchise Times*, by John M. Vernon. January 2005.

FTC Rule Makeover: Part One - U.S. Impact, *The Enterprise*, by John M. Vernon. December 2004.

Avoiding the vicarious liability trap, *Franchise Times*, by John M. Vernon. Nov/Dec 2004.

Simply e-mazing: New Support for e-disclosure, *Franchise Times*, by John M. Vernon. October 2004.

Want to Be the True Leader in Franchising? First Conquer the Middle Kingdom, *Franchise Times*, by John M. Vernon. September 2004.

2008 Olympics May Land China Franchising Gold, *The Enterprise*, by John M. Vernon. September 2004.

No Malaise For Malaysian Franchising After All, *Franchise Times*, by John M. Vernon. June/July 2004.

Malaysian Franchising: A Unique Model, *The Enterprise*, by John M. Vernon. June 2004.

Getting to the 'Core' of Franchise Bankruptcy Issues, *Franchise Times*, by John M. Vernon. May 2004.

Franchising - Italian Style, *The Enterprise*, by John M. Vernon. May 2004.

Can The Right of a Franchisor to Arbitrate Be waived in Bankruptcy? *The Enterprise*, by John M. Vernon. April 2004.

Can You Hear Me Now? Telecom Turns to Franchising, *Franchise Times*, by John M. Vernon. April 2004.

Madrid Protocol: Not Lost in Translation on Franchising, *Franchise Times*, by John M. Vernon. March 2004.

Madrid Protocol Revisited, *The Enterprise*, by John M. Vernon. March 2004

The Effect of FASB FIN 46 on Franchising, *The Enterprise*, by John M. Vernon. February 2004.

Market Conditions Favor a Franchising Renaissance in Hotel Industry, *Franchise Times*, by John M. Vernon. January 2004.

U.S. Starts Free Trade Agreement With Chile, *The Enterprise*, by John M. Vernon. January 2004.

Europe's calling: Better get your lawyer on the other line, *Franchise Times*, by John M. Vernon. April 2002.

International Franchising - Unidroit Model Franchising Law Negotiating Session: Not a Roman Holiday, International Bar Association, by John M. Vernon. October 2001.

Welcome to The Wonderful World of Cyberfranchising, Texas Lawyer, by John M. Vernon. December 1998.

Presentations

Mr. Vernon is a frequent writer and speaker on international law. A selection of recent topics includes:

Franchising 101, presented at the Park City Bar Association. November 2005.

Cross Border Acquisitions of Franchise Systems, presented at The 2005 Conference of the International Bar Association in Prague, Czech Republic, by John M. Vernon. September 25-30, 2005.

Hotel Expansion in Eastern Europe, presented at The 2005 Conference of the International Bar Association in Prague, Czech Republic, by John M. Vernon. September 25-30, 2005.

Dealing With Problems in International Franchise Relationships, presented at the IBA/IFA Joint Symposium on International Franchising in Washington, D.C., by John M. Vernon. May 2005.

Franchising and Distribution, presented at the State Bar of Texas conference in Austin, Texas, by John M. Vernon. December 9-10, 2004.

News from Around the World, presented at The 2004 Conference of the International Bar Association in Auckland, New Zealand, by John M. Vernon. October 24-29, 2004.

Practical Strategies for Resolving Disputes Arising from International Projects, presented at the International Project Development Conference in Houston, Texas, by John M. Vernon. September 23-24, 2004.

The Madrid Protocol - 7 Months of U.S. Experience, presented at the IBA/IFA Joint Seminar on International Franchising in Washington, D.C., by John M. Vernon. May 2004.

How to Save Money in Lease Negotiations, presented at IFA 44th Annual International Franchise Convention in Las Vegas, Nevada, by John M. Vernon. March 2004.

Franchising in the Hotel Industry, presented at The Lodging Conference 2003 in Phoenix, Arizona, by John M. Vernon. October 2003.

Acquisition of Real Estate in Mexico, presented at the How to Buy Real Estate in Mexico Conference sponsored by The Park City Board of Realtors in Utah, by John M. Vernon. September 26, 2003.

Franchising in the United States: Land of Opportunity, presented at the 2003 Conference of the International Bar Association, by John M. Vernon. September 14-19, 2003.

Franchising in the United States: Land of Opportunity, presented at the International Chamber of Commerce - Mexico, by John M. Vernon. September 3, 2003.

Anatomy of an International Franchise Divorce - Last Tango in Minneapolis, Presented at the 19th Annual Conference The Increasing Globalization of Franchising sponsored by the International Bar Association on Business Law and the International Franchise Association, by John M. Vernon. May 14-15, 2002.

EU-Free Trade Agreement with Mexico and its impact on franchising in the Americas, presented at International Bar Association 2001 Conference, by John M. Vernon. September 2001.

Franchising in Mexico - 2001, presented at North American International Trade Corridor Partnership Conference, by John M. Vernon. May 2001.

NAPSTER: Interpreting Copyrights in Cyberspace; a Childhood Nickname Gone Awry, presented at ALFA International Meeting of European Firms, by John M. Vernon. May 2001.

Innovative Strategies for Entering Foreign Markets, presented at The University of Texas School of Law Third Annual Telecommunications Law Conference, by John M. Vernon. March 2001.

International Franchising - Cross-Border Acquisitions Franchise Systems, presented at International Bar Association 2000 Conference, by John M. Vernon. September 2000.

Changes to Franchising in Europe Following the New Block Exemption, presented at International Bar Association Section on Business Law and the International Franchise Association 17th Annual Conference, by John M. Vernon. May 2000.

The Internet: Technology's Impact on Franchising, presented at 22nd Annual American Bar Association's Forum on Franchising, by John M. Vernon. October 1999.

An American Perspective on the Key to Successful Franchising Into Europe. Partnering with Local Counsel, presented at ALFA International Franchise Dealers and Distribution Practice Group Seminar, by John M. Vernon. October 1999.

International Franchising and Commerce, presented at International Bar Association Section on Business Law 1999 Conference, by John M. Vernon. September 1999.

International Law Firm Management in the Millennium, presented at IBA South American Regional Conference, by John M. Vernon. April 1999.

International Franchising, presented at IBA Section on Business Law 1998 Conference, by John M. Vernon. September 1998.

Representative Transactions

Franchising, Licensing and Product Distribution

Client representations in recent transactions include:

- represented a multinational hotel franchisor and an international language school in developing their Mexican franchise operations.
- facilitated a large U.S. franchisor's purchase of a 45% interest in its Mexican franchise.
- represented major automotive distribution network in connection with acquisition of a franchising company for \$5 million, and implementation of a retail all-battery franchise concept.
- represented U.S. hotel franchisor in development and implementation of franchise systems, and related regulatory compliance in over 35 countries.
- represented major U.S. software company in the establishment and organization of its Mexican subsidiary and negotiated all related software licensing agreements with third-party Mexican licenses.
- represented large U.S. trucking company in its establishment of Mexican dealership network.
- represented U.S. distributor of electronic components in the establishment of its Mexican subsidiary.
- represented major U.S. watch manufacturer in negotiations of a joint venture and licensing agreement with a large Italian clothing company to co-brand high-end watches for international sale.
- represented major U.S. textile company in the establishment of its Mexican maquiladora facility and its distribution network.

- represented large U.S. direct selling company in connection with the establishment of Mexican and Latin American direct-selling network.
- represented major U.S. automobile manufacturer in connection with the establishment of its Mexico dealership network and franchise sales program.
- represented large U.S. pizza company in connection with its co-branding program with a major U.S. retailer in Mexico.

Project Development, Energy and Finance

- assisted large UK liquids company in multi-million dollar nitrogen injection program in Mexico.
- represented global partnership in restructuring debt and project development for real estate project in Malawi, Africa.
- represented major Japanese construction company in connection with its bid on BOT project for U.S. airport facility.
- represented U.S. REIT in the acquisition and development of Mexican resort properties in Cancun and Acapulco.
- negotiated LNG “splitting contract” and “ethylene cracker” facility agreement for U.S. subsidiary energy company.
- drafted framework deal for engineering studies for domestic power generation facility.
- represented multinational oil company in connection with the privatization of 3,200 PEMEX gas stations in Mexico.
- represented U.S. oil and gas company in connection with the privatization of CNG in Mexico.
- represented major U.S. energy company in connection with the privatization of gas and electricity concessions in Mexico.

Business Establishment and Corporate

- establishment of manufacturing and warehouse facilities in Mexico for large U.S. clothing company.
- managed international oil-services corporation’s acquisition of a drilling fluids plant in Mexico.
- advised multinational oilfield supply and services company with 12 Mexican subsidiaries in Mexico and Venezuela on its numerous cross-border transactions.
- represented a multinational energy company headquartered in Dubai with annual worldwide revenue of approximately \$300 million in the restructuring of its Mexican operations and establishment of a new distribution system.
- represented Mexico’s largest entertainment company in connection with a joint venture relationship with major New York media company for U.S.-Mexico sports and entertainment tours and concerts.

Trade and Customs

- represented U.S. and foreign companies in defense of actions brought by the U.S. Customs Service for alleged violations of U.S. import and export laws.
- represented major U.S. energy company in compliance planning for Foreign Corrupt Practices Act.
- represented large U.S. equipment manufacturer in connection with preparation of compliance program for U.S. Patriot Act.
- represented several major U.S. companies in relocating to Foreign Trade Zones and establishing in-bond warehouse and distribution programs.
- represented large U.S. government contractor on trade related dispute with the U.S. Customs Service and the Department of the Treasury.
- represented Japanese automobile and trucking manufacturer on the reorganization of its U.S. dealership network and the Federal Trade Commission inquiries.
- a multi-national manufacturer with respect to alleged export violations, internal audits, compliance screening programs and ITAR and BXA “deemed export” issues.
- an aerospace R&D firm with respect to establishing an internal Export Control Compliance Program; negotiated government contracts with the U.S. military and prepared appropriate licenses vis-à-vis ITAR and EAR.
- represented global pharmaceutical corporation in its internal investigation of possible Helm’s Burton and embargoed countries violations.
- represented start-up R&D company in the classification of products and technology under ITAR, EAR and other export regimes; drafted Technical Assistance Agreements and obtained export approval for seeking to export controlled products to sensitive destinations.

INTERNATIONAL HOTEL EXPANSION

By: John M. Vernon

Presentation Outline

A. INTRODUCTION

1. Globalization of the world economy means major developing market for foreign investment opportunities
 - i. increased demand for short term lodging
 1. business travelers
 2. tourists
2. To take advantage, hotel company must partner with local investors
 - i. Typically, there are 3 forms
 1. Company Owned Units
 - a. Hotel company owns and manages
 2. Franchised Units
 - a. Investor (franchisee) owns and manages
 3. Investor Owned/Company Managed Units
 - a. Owned by investor, managed by hotel company

B. COMPANY OWNED UNITS

1. Attractive option for several reasons
 - i. Hotel company gets to keep all of the profits from a successful hotel
 - ii. Hotel company gets complete control over its brand
2. Problems with the Company Owned approach
 - i. Risk Allocation
 1. Hotel company also bears all of the risk of failure
 2. Hotel company may also bear the risk of loss during construction and/or build-out of the hotel property
 3. Risk might be difficult to determine in foreign countries
 - ii. Taxes and Repatriation Laws
 1. Usually a consideration in foreign countries without tax treaties
 2. Withholding taxes and laws affecting repatriation of funds encourage foreign firms to keep the money in the country where it is made

3. Withholding taxes are typically levied on dividends, interest, royalties and branch remittances
 - a. Can be as high as 25-30%
4. Hotel company may be taxed twice on income from a company owned unit:
 - a. once in the situs of the hotel
 - b. once in the home country of the hotel company
- iii. Missing Benefits of Local Ownership
 1. Local owner can be helpful in:
 - a. Dealing with the local government
 - i. Sophisticated local investor should know what level of government will need to approve aspects of a new hotel unit (such as building permits, etc.), and whose approval is needed at each level
 - ii. Local owner will have easier time persuading the local government to reduce or eliminate taxes and repatriation laws
 - iii. Local owner will succeed at persuading the local government to apply or interpret laws in a way favorable to the investment
 - iv. Local will be better at dealing with any local government corruption that exists
 - b. Locating the new units
 - i. Airports, City Centers, Touristy Sites
 - ii. Local will know where the hotel will have the best accessibility and visibility
 - c. Opening the new unit expeditiously
 - i. Local is better positioned to find and negotiate with a reputable local building contractor
 - ii. Hotel Company may want to use a trusted foreign firm for finishing work

C. **FRANCHISED UNITS**

1. Attractive option for several reasons
 - i. Franchisee invests its own capital
 - ii. Hotel company bears less risk of failure
 - iii. Franchisee is responsible for renovating the hotel every 5 years
2. Not a viable option in some foreign countries
 - i. No market for franchises

1. Few franchise systems have any brand recognition in developing countries
2. Not enough value in a major Western hotel company's trademark to pay a large amount of money for it
3. Western companies are wealthy, so they should put up their money
- ii. No local experience managing hotels
 1. Hotels located in communist countries were owned and run by the state
 2. Those not run by a communist government may have reputation as being poorly run
- iii. No culture of disclosure
 1. Open and honest disclosure is a hallmark of franchising
 - a. Disclosures prior to sale
 - b. Revenue reporting after a sale
 2. Some non-Westerners are not used to the idea of full disclosure
 - a. Local may be suspicious of pre-sale disclosure
 - b. Local may resist allowing an audit of accounting

D. **INVESTOR OWNED/COMPANY MANAGED**

1. Popular because hotel company makes money with little risk of loss
2. Management agreement structured so hotel company receives management fees that exceed potential royalties under a franchise agreement
3. Management Fees have a fixed portion and an incentive portion linked to the performance of the hotel
4. Particularly attractive for international expansion
 - i. Risk can be greatly reduced by having a high fixed fee and a low incentive fee
 - ii. Gives hotel company control over the brand
 - iii. Hotel company enjoys benefits of local ownership
5. Has some of same problems as franchising
 - i. Local investors say rich Western companies should put up their own money

E. **THE SOLUTION**

1. Joint venture in ownership of hotel
 - i. Experience: hotel company has no more than 20% ownership stake
2. Hotel company manages the hotel
3. Advantages
 - i. Hotel company gets benefits of local ownership

- ii. Hotel company exposed to low risk but can obtain high revenue
- iii. Local investor demand for rich Western company to invest money is satisfied

2006 Hospitality Law Conference

Houston, Texas
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CARSTENS & CAHOON, LLP

The International Perspective on Hospitality Legal Issues

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Introduction

- International Expansion is Major Developing Market
 - Most Developing Countries' GDP Growth > 5%
- Expansion Opportunities for Lodging Industry
 - Increasing Tourism
 - Increasing Business Travel

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Introduction

- Expansion Comes In 3 Forms
 - Company Owned Units
 - Franchised Units
 - Investor Owned/Company Managed Units (IO/CM)
- Each Method Has Pros and Cons vis-à-vis International Expansion

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Company Owned Units

- Advantages
 - Hotel Company Keeps the Profits
 - With other methods, Hotel Company only gets a portion of the profits
 - Hotel Company Completely Controls the Brand
 - Other methods give outsiders some control over the hotel

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Company Owned Units

- Advantages are Really Disadvantages in Foreign Countries
 - Risk Allocation
 - Hotel Company keeps all the profits, but also has all risk of failure
 - Level of risk in certain areas more difficult to determine than established regions
 - Example: Eastern Europe perhaps more risky than established regions

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Company Owned Units

- Advantages are Really Disadvantages in Foreign Countries
 - Taxes and Repatriation Laws
 - Withholding Taxes
 - Can be as high as 25% to 30%
 - levied against branch remittances and royalties
 - Repatriation Laws
 - Keeps the money where it is made
 - Forces Hotel Company to re-invest in that country

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Company Owned Units

- Advantages are Really Disadvantages in Foreign Countries
 - Taxes (continued)
 - Income Taxes
 - If no tax treaty, can be taxed twice on income
 - Once in situs of hotel
 - Once in home country

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Company Owned Units

- Misses Benefits of Local Ownership
 - Dealing with Local Government
 - Local can navigate local bureaucracy better than foreigner
 - Knows what level of government needs to give approvals for project
 - Knows who in local government to contact

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Company Owned Units

- Benefits of Local Ownership
 - Dealing with Local Government
 - Local can Persuade Government to Change or Selectively Apply Laws
 - Because a Local is benefiting, Government is more likely to:
 - Reduce withholding taxes
 - Reduce repatriation laws
 - Apply favorable law if more than one law applies
 - Local will know where corruption lies and how best to deal with it

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Company Owned Units

- Benefits of Local Ownership
 - Taking Advantage of Local Knowledge
 - Big Factor in Success: LOCATION
 - Airports
 - City Centers
 - Touristy Sites
 - ACCESSABILITY
 - Poor Infrastructure in some Developing Countries
 - Locals will know which locations are adaptable to needs of the Hotel (e.g. parking lots)

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Company Owned Units

- Benefits of Local Ownership
 - Project Completion
 - Locals will be in best position to:
 - Know reputable builders
 - Negotiate the lowest price
 - Foreign company seen by local builder as having deep pockets
 - Western Firm may be better at finishing touches
 - Furnishing, painting, fixtures, etc.

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Franchised Units

- Advantages
 - Lower Risk
 - Franchisee puts in its own capital
 - Renovations
 - Owner of hotel (franchisee) has to bear the cost of renovation about every 5 years

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Franchised Units

- Problem - Viability
 - No Market for Franchises
 - No Brand Recognition in many Foreign Countries
 - Not enough tourists or business travelers yet to justify large investment in Brand
 - Investors' Attitudes towards Western Companies
 - Western Companies have deep pockets
 - They should put their money into the deal

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Franchised Units

- Problem - Viability
 - No Local Experience Running Hotels
 - In some countries' pasts, the state ran the hotels
 - Difficult to find local investors with enough experience to manage and operate the hotel

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Franchise Units

- Problem - Viability
 - Attitude Towards Disclosure
 - Culture not accustomed to full disclosure as the West
 - A franchise hallmark is open and honest disclosure
 - Pre-sale disclosure by franchisor
 - Non-Western countries may be skeptical
 - Post-sale disclosure of revenues for calculating royalty
 - Foreign owners may resist formal audit of books

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IO/CM Units

- Advantages
 - Management Agreement
 - Can make more money for Hotel Company than Franchise Agreement
 - Can be structured to reduce risk to Hotel Company
 - High fixed fee
 - Lower incentive fee linked to performance of hotel
 - Particularly attractive for possibly risky regions
 - Gives Hotel Company more control over Brand
 - Enjoys Benefits of Local Ownership

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IO/CM Units

- Problems
 - Same Roadblocks as Franchising
 - Investor Attitude Towards Rich Western Companies
 - Deep Pockets
 - Should invest their own money
 - Local Investors don't want all risk of failure

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The Solution

- Joint Venture
 - Partially Owned by Local Investor
 - Partially Owned by Hotel Company
 - Experience: no more than 20% HC ownership stake is best
 - Managed by Hotel Company

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The Solution

- Joint Venture Benefits
 - Takes Advantage of Local Ownership Benefits
 - Exposes Hotel Company to Less Risk than Company Owned Units
 - Can Bring in More Revenue
 - Management Fee +
 - Partial Owner Portion of Profits
 - Satisfies Local Demand for HC Investment

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QUESTIONS?