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MOCK NEGOTIATION – HOTEL MANAGEMENT AGREEMENT Owner vs. Manager

PRESENTERS



■ Representing the Owner

■ LARRY MUNDY

- DEPUTY GENERAL COUNSEL
- FELCOR LODGING TRUST INCORPORATED, IRVING, TX



■ Representing the Manager

■ BHAVANA S. BOGGS

- VICE PRESIDENT AND ASSISTANT GENERAL COUNSEL
- THE RITZ-CARLTON HOTEL COMPANY, CHEVY CHASE, MD



■ Moderator

■ MITCHELL S. BERKEY

- PARTNER
- WOLFF & SAMSON PC, WEST ORANGE, NJ

Manager Compensation

Base Fee

- **Industry norms**
- **Ramp up during the term**
- **Nature and extent of financial support provided by Manager (e.g., equity investment, debt, guaranty, key money)**

Incentive Fee

- Nature of the fee
- Subordination of Incentive Fee to Owner's "Priority," i.e., Owner's required return
- Determining subordination formula

Marketing Fees, System/ Corporate Charges and Shared Services

- **Marketing fees**
- **Distribution systems, brand standards, other reimbursable costs**
- **Specification of services/costs, caps or limits on ability to alter or increase**

Term

Manager Goals

- Long term commitment
- 10-30 year initial term depending on property type

Manager Goals, con't.

- **Renewal rights exercisable by Manager, e.g., one or more multi-year renewal terms**
- **Longer initial term and renewal rights especially if Manager provides financial support, e.g., equity investment, debt, guaranty or key money**

Owner Goals

- Flexibility and shorter duration of commitment
- Shortest possible initial term, e.g., 5-10 years

Owner Goals, con't.

- **Limit renewal rights to Owner only**
- **Limited, if any, renewal rights exercisable by Manager and conditioned on meeting performance benchmarks**

Termination Rights

Manager Goals

- **Limit Owner's ability to terminate**
- **Acknowledges need for Owner right to terminate for:**
 - **failure to meet performance benchmarks**
 - preference is a two-prong test
 - **default by Manager**

Manager Goals, con't.

- Cure rights in favor of Manager
- Condition termination on redemption/repayment/termination of financial support provided by Manager (e.g., equity investment, debt, guaranty, key money)
- Termination fee to Manager

Manager Goals, con't.

- Retain management agreement in event of ownership transfer
 - No termination if hotel is sold
 - Limit termination rights of Owner's lender
 - the SNDA requirement

Manager Goals, con't.

- **Restrictions on sale of hotel**
 - No sale to a competitor of Manager or other unacceptable purchaser
 - Establishing criteria for unacceptable purchaser, i.e., the “Beauty Contest”
 - ROFO and/or ROFR for Manager
- **Manager’s right to terminate for**
 - Owner’s failure to meet brand standards
 - Owner’s default

Owner Goals

- **Right to terminate upon:**
 - failure to meet performance benchmarks
 - default by Manager
 - sale or other ownership transfer
 - change in Manager ownership or key personnel

Owner Goals, con't.

- Reasonable performance benchmarks primarily focused on operating profit
- Limit cure rights of Manager
- No or limited termination fee to Manager

Owner Goals, con't.

- No restrictions on right to sell hotel
- No ROFO or ROFR
- “Beauty Contest” only applies upon assignment of agreement

Performance Standards/Investment Objective Benchmarks

Single Prong vs. Multi-Prong Test

- Testing periods
- Necessity for failure of one prong or both prongs

Operating Profit Test

- Defining “Operating Profit” – the return on Owner’s investment
- Defining “Deductions” for purposes of calculating Operating Profit
- Establishing the Operating Profit benchmark

Market Test

- **Hotel Performance vs. the relevant market aka the Competitive Set**
- **Performance as measured by RevPAR – Revenue Per Available Room**

Market Test, con't.

- **Defining the Competitive Set**
- **Establishing the performance benchmark in terms of a % of RevPAR of the Competitive Set**
- **Revising the Competitive Set/Performance Test during the term – expert resolution process**

Manager vs. Owner

■ Manager Goals

- Need an appropriate “ramp up” or stabilization period before performance test begins and Owner’s performance-based termination rights apply

Manager vs. Owner, con't.

■ Manager Goals, con't.

- Conditions and carve-outs to Owner's exercise of performance-based terminations right
 - Force majeure/"extraordinary event"
 - Default by Owner
 - Lack of compliance with Manager's system standards not due to Manager
 - Hotel renovations

Manager vs. Owner, con't.

■ Owner Goals

- Limit ramp up or stabilization period before performance test begins and Owner's performance-based termination rights apply
- Limit conditions and carve-outs to Owner's exercise of performance-based termination right

Termination Fee to Manager

Termination Fee to Manager

- **Amount: fixed amount vs. declining balance**
- **Negotiating Factors**
 - **Triggering event for the termination**
 - **Point during the term at which termination is triggered**

Termination Fee to Manager, con't.

- **Negotiating Factors, con't.**
 - **Nature and extent of financial support provided by Manager (e.g., equity investment, debt, guaranty, key money)**

Operational Control of the Asset

Day-to-Day Operations/ Key Employees

■ Manager Goals

- Ability to operate with minimal Owner interference/approval
- Ability to follow approved operating and capital budgets without revision by Owner
- Right to select, train, supervise employees
- Limit approval rights of Owner over selection/termination of key employees

Day-to-Day Operations/ Key Employees, con't.

■ Owner Goals

- Appropriate oversight/approval rights on Manager activities
- Limit Manager ability to review/revise budgets/operating plans

Day-to-Day Operations/ Key Employees, con't.

■ Owner Goals, con't.

- Periodic operations meetings with Manager
- Approval rights over selection and termination of, General Manager, Director of Finance, Director of Sales, Food & Beverage Manager, and other key employees

Financial Accounting/Reporting

■ Manager Goals

- Control of hotel books and records
- Control of operating accounts
- Standardized reporting to Owner

Financial Accounting/Reporting, con't.

■ Owner Goals

- Right to audit hotel books and records
- Signature authority on operating accounts

Financial Accounting/Reporting, con't.

■ Owner Goals, con't.

- Opportunity to meet regularly with hotel personnel to discuss hotel financial performance and operations
- Proper accounting definitions of metrics that drive incentive fees, performance goals, etc.

Establishment, Control and Application of FF&E Reserve and Capital Expenditures

■ Manager Goals

- Appropriate reserves for FF&E
 - Right to require Owner to fund additional FF&E amounts
 - Right to draw upon FF&E reserves

Establishment, Control and Application of FF&E Reserve and Capital Expenditures, con't.

- **Manager Goals, con't.**
 - **Owner obligation to fund non-FF&E capital expenditures**
 - **Owner obligation to fund capital sufficient for hotel to meet brand standards**

Establishment, Control and Application of FF&E Reserve and Capital Expenditures, con't.

■ Owner Goals

- Limit amount of capital reserves
 - Restrict spending by Manager to reserve amounts
 - Notice and oversight on Manager drawing upon reserves

Establishment, Control and Application of FF&E Reserve and Capital Expenditures, con't.

- **Owner Goals, con't.**
 - Owner discretion regarding funding of non-FF&E capital expenditures
 - Owner participation in, or control over, FF&E and capital projects; “soft” funding of reserves

Financing Considerations – Debt/Equity Ratio, DSCR, Acceptable Lenders

Manager Goals

- Avoidance of excessive leverage
- Limitation on field of debt types

Manager Goals, con't.

- **SNDA – Ability to have management agreement survive foreclosure**
- **SNDA – Assurance that lender will make cash available/cure defaults of owner**

Owner Goals

- No undue restriction on types of financing, pooling, etc.
- Ability to meet lender requirements and secure the loan
- SNDA – Flexibility for lender to control cash, terminate the Manager, and reposition the property

Competing Facilities/Territorial Restrictions

Manager Goals

- Ability of Manager and affiliates to operate in proximity to the site
- Limited area and duration of non-competition by Manager

Owner Goals

- **No competition from Manager or affiliates, including brands under same loyalty-point system**
- **Broader area and longer duration of non-competition by Manager**