

**SPECIAL CONSIDERATIONS WHEN NEGOTIATING AND DRAFTING
PURCHASE AGREEMENTS FOR HOTELS AND RESORTS**

By Russell C. Savrann

GRAHAM & DUNN P.C.
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Russell C. Savrann
Of Counsel

Hospitality, Beverage & Franchise, Business
Transactions
800 Village Walk #157
Guilford, CT 06437-2740
(203) 653-2820 (CT main)
(206) 340-9665 (WA main)
(206) 340-9599 (fax)
rsavrann@grahamdunn.com

Professional Experience

Joined Graham & Dunn, 2005

Vice President and Associate General Counsel, Starwood Hotels & Resorts Worldwide, Inc., 2000 – 2005
Acting General Counsel, Director of Legal Affairs and Corporate Secretary, The Ground Round, Inc.,
1994 – 2000

Private Practice Boston MA, 1987 –1994

Admitted to Practice: Massachusetts, 1987; Florida, 1988; New York, 2003; Connecticut, 2004

Russ is a member of the firm's Hospitality Industry Group. He works with hotel and restaurant clients on strategic planning, transactions, franchising and operational matters, including mergers & acquisitions, joint ventures, corporate organization, management agreements, franchise, beverage licensing, intellectual property, sales, marketing, construction and procurement. Russ has worked with national and international developers and hospitality companies on global transactions in Argentina, Costa Rica, Fiji and Mexico, as well as condo-hotel and mixed-use resort projects throughout the United States. Russ has documented transactions for clients with Carlyle Real Estate Group, Normandy Real Estate Partners, Behringer Harvard and Westbrook Partners.

Russ currently serves as counsel for the National Association of Condo Hotel Owners, Northview Hotel Group, Hay Creek Hospitality and Lifestyle Hotel Group and has assisted the start up of these companies with strategic and business planning, corporate organization and compliance, employment, capitalization and joint venture partnerships.

In addition to hospitality law, Russ has experience in the areas of real estate, technology, employment, commercial litigation and bankruptcy.

Prior to joining Graham & Dunn in 2005, Russ served as Vice President and Associate General Counsel and Assistant Secretary of Starwood Hotels & Resorts Worldwide, Inc. from 2000-2005, where he represented several business groups, including development, sales and marketing, group business,

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intellectual property (worldwide), operations, food & beverage, architecture, design and construction, technology (Galaxy Hotel Systems and STARS) and procurement.

As Acting General Counsel, Director of Legal Affairs and Corporate Secretary at The Ground Round, Inc., from 1994-2000 Russ served within the executive management team of a national franchise company that owned, managed and franchised over 200 casual dining restaurants through out the USA and Canada. During Russ' term, Ground Round was a public company, was taken private, sold and refinanced.

Professional and Community Activities

American Bar Association, Real Property, Probate and Trust Section, Hospitality, Community Recreation and Common Interest Developments Group member

Massachusetts State Bar Association

Florida State Bar Association

New York State Bar Association

Connecticut State Bar Association
Red Ribbon Association

Presentations and Publications

Presenter, "*Sidestepping SEC Trouble: Complying with Securities Laws,*"
ACI Condo-Hotel Conference (South Beach, Florida, November 30, 2006)

Presenter, "*The Deal is the Real Thing - Experts Review Real Deals,*"
International Hotel Conference (Rome, Italy, October 12, 2006)

Presenter, "*International Legal Considerations,*"
HSMIA World Quest (Seattle, Washington, August 4, 2006)

Presenter, "*International Security Measures,*"
HSMIA World Quest (New York, New York, July 24, 2006)

Presenter, "*International Legal Considerations,*"
HSMIA World Quest (New York, New York, July 24, 2006)

Presenter, "*Condo Hotel Rental Agreements,*"
Hospitality Law Conference (Houston, Texas, February 2, 2006)

Presenter, "*Current Hotel Industry Trends and Legal Effects,*" International Society of Hotel Association
Executives, (Portland, Oregon, December 8, 2005)

Education

J.D., Suffolk University School of Law, 1987

B.A., Emory University, 1984

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SPECIAL CONSIDERATIONS WHEN NEGOTIATING AND DRAFTING PURCHASE AGREEMENTS FOR HOTELS AND RESORTS

The hotel/resort purchase agreement (“**PSA**” or “**Agreement**”) has much in common with other business/property acquisition documents, however it holds a few unique elements. In addition to the brick and mortar asset, the hotel must continue to operate through the transaction as an ongoing retail business without degradation of good will. Cash flow and renovation cycles, pro-rations, employment, concessions, permitting and branding considerations do not, in and of themselves, differ from other businesses, it is the combination and relationship of these issues that make the hotel transaction unique. The PSA must address operations during the period from contract to close as well as future business (such as to continue to accept reservations for groups). Prior to entering into the Agreement, a Buyer should have a preliminary plan that will dictate the scope of the property improvement plan (“**PIP**”) and whether the Hotel should remain open during the renovation.

This paper is an outline of issues to consider in the drafting and negotiation of a PSA. Some of these comments and observations are basic others may be more interesting; all are important.

1. **Be sure you are not inadvertently purchasing a manager along with the property and its improvements.**
 - a. Determine if the hotel operated by a third party manager.
 - (1) When a hotel is managed pursuant to a management agreement, the termination of the management agreement must be a condition of closing.
 - (2) Build the termination notice period into your schedule.
 - (3) Be sure the Seller retains ownership of rights to guest data, copies of employee files and that any severance or termination penalties are negotiated business terms.

2. What is the right deposit amount?

- a. The amount of the deposit is a negotiated term riding on Seller's need to cover its potential lost opportunity costs if the deal falls through, ensuring the Buyer has enough equity in the transaction to bring it to closing.
- b. Some Sellers and brokers set the deposit amount as a means test to filter out under capitalized Buyers.
- c. During the due diligence period, deposits should be stepped with an initial refundable sum tendered to an escrow company and followed by a larger, subsequent deposit amount. That sum, with the initial deposit, becomes non-refundable subject to closing conditions. A third party escrow company, preferably a title company, should hold all deposit money.
 - (1) There is no reason to tie up a large sum with an initial deposit.
 - (2) Interest should be applied to the deposit and should be applied against the purchase price at closing.
 - (3) Often, a developer prior to securing an equity partner for the transaction places the initial deposit. In this circumstance the initial deposit will be returned to the Buyer and the full deposit will be re-tendered. This allows the developer to substitute 100% funds for its pro-rata proportion in the venture. This can be an important cash management application.

3. Inspection and Due Diligence, with an "As is Sale".

- a. The Seller will require the Buyer to indemnify for any damages or claims that arise during the inspection period. The Buyer and Seller should identify a single person on the property to coordinate the timing and location of inspections and to ensure that a protocol is established to know who is on property, and that they have provided the Seller and Buyer with evidence of insurance naming both parties as additional insured.
- b. With a short due diligence period, advance consent for access to the property for consultants for the PZR, Environmental, ADA reports should be requested and granted.
- c. The Seller should not be given longer than one week to provide Seller information including title. Strict adherence to this quick return is essential. It is common for the broker or Seller to have set up an online "war room". Ask for an index of the materials in the war room to determine if it is complete and comprehensive.

- d. If the war room is incomplete or if the due diligence materials are not online, there is a risk that materials could be missing or misfiled if the property has been subject to previous due diligence.
- e. The broker often is the point person for the Seller. Make sure the broker is capable and has pulled together relevant information. In a mixed-use project, not all of the documents relating to the other interests may be in the war room. Often the declarations and CCR are not recorded and the Seller and /or broker will have you rely on the title and survey to find the documents. In a short due diligence this can be a costly delay. Insist that all CCR are recorded and relevant documents are provided including a plan with the boundaries of each component hatched off. In addition have the broker or Seller provide you with a detailed flow chart of all of the interrelated parties, what costs and obligations are shared. For example, in a mixed-use property with a residential component with shared common areas such as roads, green space, gatehouse and landscape, you understand who controls the HOA and any architectural control committee before upgrading the hotel component.
- f. A Seller may choose to limit the due diligence, such as not allowing a Phase II study. This does not necessarily mean the Seller is hiding a condition. The representation and warranty provisions will address fraud. However, if a Phase I report recommends a Phase II, then the Seller may prefer to lose the deal and evaluate the environmental issue outside of a transaction.
- g. The time allotted for the due diligence period should be carefully considered.
 - (1) Generally, the market dictates the time the Seller will provide.
 - (a) In a Sellers market, the due diligence periods are compressed. In many cases the due diligence periods are so short that it is unreasonable for the Buyer to access, review and analyze the information and reports generated in the time provided. When the due diligence period is too short, the nonrefundable deposit amount becomes a materiality threshold on due diligence matters.
 - (b) One strategy is to build in extensions for due diligence based on the inability to schedule critical consultants, and or Seller's failure to provide complete and satisfactory Seller's information by a certain date.
- h. On average due diligence on a large property can be performed within six months, if pushed four months. For a shorter period, calculate the cost of the deposit and

be prepared to leave the deposit if the property does not meet your requirements, or has conditions that are unacceptable.

4. Operating the hotel prior to closing.

- a. There is a risk that pending closing the property could be degraded. At minimum, the Seller should agree to continue to do business in ordinary course including ongoing maintenance and improvements. An inventory of FF&E and soft goods should be made early. This can be very important if the hotel has original art and other valuable property, otherwise at closing the property may be scheduled as personal property of the Seller and excluded from the sale.
 - (1) If the Buyer is going to perform a major renovation through a PIP, the Seller may see good money being wasted. The guest experience is still important. The reputation and location of the hotel, transcends the ownership. Many hotels and resorts have had multiple Sellers and have seen many renovations, however the guest or client if he or she is to return (especially group business) should not be subjected to torn carpets and dysfunctional systems.
 - (2) Review the sales and advanced reservations cycle of the property to determine how far into the following year(s) you are to accept reservations. If the hotel has large group bookings during a period when room inventory will be reduced for the PIP, a shortage of room inventory could disrupt an event or invite litigation. In addition, look to the positioning of the hotel. If the hotel is currently a tourist or economy property and after PIP it will be branded an upper or upscale property, you may consider restricting future FIT business. The Buyer shall approve all group contracts (FIT or otherwise) in excess of a set dollar amount booked more than a set period of time (six months or a year).
 - (3) During the period prior to closing certain leases, concessions and contracts may be due for renewal, or scheduled to be executed, that will have an expiration date post closing. All such agreements if they do not have a thirty day termination without penalty, should require the Buyer's consent. A carve out may be made for agreements and licenses necessary for the regular operation of the hotel such as liquor and food permits.
 - (4) Be sure to consult with counsel specializing in liquor/beverage licensing to address the procedure and timing for the issuance of a new license and to determine (1) if the license will be contingent on other inspections and permits and (2) whether the Buyer can operate under a Beverage Service Agreement ("BSA"). The cooperation of the Seller is paramount. Even in

a state where licenses are issued as a matter of right, the application process should be commenced immediately upon execution of the PSA. If a BSA is contemplated, an agreed upon form should be attached. In some states, such as New Jersey, a more complicated structure is required. In other states there is no alternative but to operate under a new license. The timing of closing should be matched to a realistic issuance date.

- (5) No executive level hiring should be done without the consent of the Buyer.
- (6) Ensure that your purchase will cover only usual and ordinary inventory of supplies and materials.

5. Closing Considerations.

- a. It is market to close the books as of midnight the night before the closing for room revenue. Room revenue is to be divided equally and all other revenue such as F&B and vending receipts go to Seller prior to midnight and then to Buyer after midnight. Therefore Buyer is getting revenue from the hotel restaurants, concessions etc on the day of closing. The value of clean rooms benefits the Buyer. Be sure to cover payment for rooms cleaning the night before closing.
 - (1) In addition to utility readings, Buyer should request the assignment of utility deposits and credit Seller at closing. Seller's obligation to assist Buyer in the transfer of utilities should survive closing.
 - (2) To what extent should the Buyer be responsible for the collection of receivables due to the Seller post closing?
 - (a) One option is for the Buyer to pay Seller for its receivables that are aged forty-five days or less as of the cut off date. Buyer will then have no further responsibility to Seller for receivables collected.
 - (b) Alternatively the Seller may request that the Buyer cooperate with the collection of receivables and/or take affirmative steps to collect receivables for the Seller. In that circumstance, the Buyer shall not be obligated to undertake any additional collection efforts with respect to such amounts. The Seller should retain the right to pursue the collection of all such amounts not credited at closing and retain all such amounts collected. Seller should give Buyer advance written notice prior to taking any legal or collection activities. The Buyer should reasonably cooperate with Seller's attempts to collect any such sums at Seller's expense. Conversely,

Buyer can agree that it will not waive, settle nor compromise any claim with respect to such receivables without the prior written consent of Seller.

- (3) Payables should be adjusted ninety days after closing. If there is a concern that Seller has not maintained current payments or padded inventory, Buyer should adjust any holdback to cover the anticipated liability.
- (4) The handling of guest property.
 - (a) As of the date of closing all bags and personal property of the guests left in the care of the hotel are to be tagged jointly by Seller and Buyer. The parties should indemnify each other for any claims relating to their acts or omissions with regard to the baggage based on the actions of Buyer or Seller from when they had control over the property.
 - (b) Guests who have placed items in the safety deposit boxes or vault should be notified at least 24 hours prior to closing and requested to open the box in the presence of both Seller and Buyer for an inventory. If the guest objects to the Seller and Buyer viewing the contents on privacy grounds a written affirmation from the guest that all property is present will suffice. If a guest does not open and inventory the box prior to closing, the box will be sealed. When the guest requests access to the box the Seller will be afforded with reasonable advance notice under the circumstances the opportunity to view and inventory with Buyer the contents at that time. If parties follow this or such similar procedure the Seller is responsible for contents prior to closing and Buyer responsible for contents post closing.
- b. Closing costs should be researched prior to entering into the Agreement. Generally each party pays their own legal and consulting costs and split equally title premiums, survey costs, documentary, mortgage or other recording taxes. In some jurisdictions the practice is for one or the other party to cover all the title or recording costs. This can be material and should be reviewed prior to acceptance. In Florida or New Hampshire for example, the cumulative recording taxes are in excess of eight percent.

6. Representations and Warranties and Indemnity Baskets.

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- a. The representations and warranties of seller need to be broad enough that you can rely on the due diligence information provided by Seller to be accurate, comprehensive and truthful. The Seller doesn't want to be held liable for minor inaccuracies or to have uncapped liability. At the same time, post closing the Buyer wants to be sure funds are available for recourse.
- b. The Seller's representations and warranties should survive closing for at least one year (excepting taxes which are known). The Buyer should have at minimum one year, preferably two years to file a claim against the Seller. The hotel should go through at least a full year audit cycle to assimilate the business.
- c. Consider the use of an Indemnity Basket to address the need for survival of funds to back up the Seller's indemnity. What is the right amount to place in the Indemnity Basket? Each deal has its own conditions and concerns. It is easy to calculate the indemnity cap based on the purchase price of the asset at 3-5%, however, this may lead to a failure to cover the liability or over compensating for the real risk. If a percentage is used it is better to calculate the percentage excluding land value and good will. The remaining building and property values should be a starting point for the percentage calculation. However on a smaller property the 3-5% percentage number on the full purchase price may be insufficient to cover a serious claim.
 - (1) A careful review of the existing and past litigation history for this specific asset and other similar assets will provide a guideline for litigation liability. For example look to employment practices and recent employment history. Based on the number of employees participating or excluded from benefits, will there be sufficient funds in the basket to cover an ERISA claim? Also look to the amenities and activities of the guests at the property. A business hotel will have a lower likelihood of claims than a mixed-use property with complex inter-relationships and obligations. A resort property with pools and or beach should have a higher cap.
 - (2) The Seller does not need to be harassed with nuisance claims either so a floor is important. This is a negotiated term but generally on a smaller property, claims with a value less than \$25,000 should be below the cap unless in the aggregate the claims exceed \$25,000. On larger properties with seven figure baskets the floor can be \$100,000.

7. **Damage, Destruction or Condemnation of the Property**

- a. The threshold of material damage, in the event of a casualty to the property, should be reviewed with a risk management consultant to match the insurance

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criteria. In addition consider that a monetary number may not cover the impact of a loss of a critical component of the property, that due to insurance, zoning or engineering concerns, cannot be replaced. For example loss or damage to a residential component of a resort, although not a direct part of the hotel property may, if not subject to immediate repair, have a material adverse effect on the property and should be addressed in the purchase price or in the decision to close.

- b. Should the Buyer go forward with the transaction the Seller's insurance proceeds are to be assigned. The Seller's lender may have claims on the insurance proceeds with priority over the PSA terms. Be sure to cover the retention amounts due the carrier as an adjustment to the purchase price.

8. Employees.

- a. The Parties should agree to make a joint announcement to all hotel employees concerning the sale of the Hotel. Such announcement shall take place at the Hotel at a time mutually agreeable to the Parties, but not more than five (5) days prior to the Closing Date, or such earlier time as mutually agreed upon by the Parties. Upon reasonable advance written notice to Seller after the expiration of the due diligence period, Seller should permit Buyer reasonable access and opportunity to interview all hotel employees for future possible (or continued) employment with Buyer following the Closing Date. Seller shall, unless otherwise notified in writing by Buyer, at least two (2) days prior to the Closing Date, terminate as of the Closing Date at no cost to Buyer the employment of all hotel employees, consistent with applicable law. Seller should pay all employee benefits and entitlements due upon termination including but not limited to earned but unused vacation privileges of all hotel employees as of the date of closing. Seller shall indemnify Buyer for any and all claims from the employment and termination of hotel employees including WARN ACT. This indemnity shall survive the closing.

9. Conclusion

The negotiation and drafting of a hotel PSA requires, in addition to the general requirements of an asset purchase, a familiarity with hotel business and the operation of the particular asset. As more mixed-use properties are developed, the considerations and complexity of such projects requires more care be provided in the PSA. Often there is pressure to "seal a deal" with a quick turn of a purchase agreement; care should be taken to balance the need for speed with covering all of the material requirements of the transaction.