TRENDS IN HOTEL RECEIVERSHIPS

Alissa M. Nann
Foley & Lardner LLP

State of Play

Bankruptcies in the hotel industry haven't been as prevalent as predicted at the beginning of the pandemic. The industry expected to see a tidal wave of bankruptcies due to the business impact from COVID-19, from stay at home orders and non-essential designations, to lack of leisure and business travel even as restrictions were lifted. Instead, there has been an uptick in receiverships, which are faster, cheaper and more flexible.

A receivership can:

- Be a helpful tool for a lender to gain control of the property pending foreclosure, put in new management (if needed), address performance issues, and possibly sell through a court fiduciary.
- Put pressure on a borrower to find new financing/come up with financial proposal to address delinquencies – "put their money where their mouth is."

Advantages of Receivership over Bankruptcy

The biggest advantages of a receivership versus a bankruptcy are control (for a lender), speed and cost.

Receivership:

- After borrower defaults on mortgage, lender can seek appointment of a Receiver
- Loan documents typically provide for a Receiver after default. Courts usually enforce the loan documents and appoint the Receiver if a default exists.
- Borrower often consents to the Receiver unless it contests the default
    - If the borrower and lender can negotiate a consensual receivership order in advance, some courts don't even require a hearing to appoint the receiver. This varies from court to court.

- Lender typically has a lot of influence in the selection of the Receiver (although court may appoint its own choice).
- With fewer hearings before the judge and fewer motions to be filed, the costs are significantly less for a receivership than a bankruptcy.

Receivers are entitled to "quasi-judicial immunity". In 2021, the Third Circuit upheld a decision finding that, just as judges cannot be held liable for their decisions, court-appointed receivers deserve immunity "when they act with the authority of the court." The Supreme Court recently denied cert to hear an appeal of that decision, which now stands as good law. *Lan Tu Trinh v. David Fineman*, case number 20-1727, in the Supreme Court of the United States.

Bankruptcy:

- A borrower can file a voluntary bankruptcy petition to stay a foreclosure proceeding, or Lender can file an involuntary proceeding against a borrower, if they meet certain criteria required by the Bankruptcy Code – may need to join with other creditors to file.
- Bankruptcy cases generally require many more court hearings, and require borrowers to disclose a lot of information, which can be timely and expensive to prepare, and require additional professionals, which up the cost.
- There may be a creditor committee looking for ways to monetize the debtor's assets to pay unsecured creditors.
- Lender has limited control over a bankruptcy sale process. Debtor has to accept "highest and best" offer, which doesn't necessarily mean the most money.
- If the case is converted to a chapter 7 (or a chapter 11 trustee is appointed), a third party is appointed by the court to control/liquidate the assets of the debtor, and is statutorily entitled to 3% of sale proceeds of debtor's assets.

Lender Considerations

Lenders need to be mindful when financing options are available to borrowers—a borrower may be more likely to file a bankruptcy to take lender control away from the process. In a bankruptcy, a borrower can "cram down" a plan or sale on a lender. Lenders need to decide if they're willing to provide new money to a borrower to avoid a bankruptcy and have some control

over the future/process. If a borrower can recapitalize, that's a benefit to both parties, and something that the lender can't get through foreclosure of the real estate.

Need for Skilled Receivers

Hotels are different than other commercial real estate, with unique characteristics, such as 24/7 operations, rents that reset daily, may be subject to franchise and management agreements, subordination and non-disturbance agreements, and union collective bargaining agreements. If the receiver doesn't understand these unique characteristics of the hotel, she/he will have difficulty facing them.

Unions/CBA Issues

With union hotels that closed due to Covid, it's often cheaper to keep certain hotels closed than open them with unions.

Active vs. Closed Considerations:

- Does the hotel employ bargaining unit employees? If not, might not be obligation to recognize union. If not, when anticipated operations will resume?
- Size of workforce - can hotel operate under CBA with reduced staff?
- Is CBA impediment to profitability? Determine whether hotel can afford union wages and benefits. If not, consider seeking concessions to remain open.