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# Hotels and leisure

## Key terms for hotel management agreements

### Issue 5 – Restricting transfer of the hotel to a competitor

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“Ranked top tier in  
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This is the fifth in a series of short briefing notes identifying key issues for discussion when agreeing the terms of a hotel management agreement (the HMA). We briefly identify the typical position adopted by each interested party and further issues for consideration when negotiating from such a position.



#### Restricting transfer of a hotel to a competitor

A common point of negotiation in an HMA is the restrictions placed on the owner when transferring the hotel or the hotel owning company to a third party. The starting position for most operators is that an owner may not dispose of the hotel unless the incoming owner is financially sound (although practically an owner would argue that a person positioned to purchase a hotel would be assumed to be financially sound), does not have a criminal record and is not otherwise generally recognized as being of ill repute, agrees to take over all of the obligations of the HMA (meaning the HMA will continue notwithstanding the transfer) and the new owner is not a competitor of the operator or its affiliates. This restriction on transfer to a competitor, however, is one area of increasing discussion between parties as the hotel and leisure sector expands and the key players in the industry diversify. In today's market, it is not always clear who a “competitor” to an operator and its affiliates is and how wide an impact such restriction will have in practice.



#### The operator's position

From the operator's perspective, not only will the operator want the HMA to be binding on an incoming owner (thereby protecting the operator's investment in the hotel and its revenue stream), the operator also wants to ensure that the owner will work collaboratively with the operator to act in the best interests of the hotel. Having an owner who is simultaneously competing with the operator means that the operator will be required to do business with a party that may be actively aligned against the operator's interests in the market which could in turn threaten the hotel's operations and revenue stream. In addition, the greatest asset of a hotel operator is its management expertise and, in the case of the branded operators, the intellectual property in the brand. A hotel operator will not want to disclose such valuable information to a competitor who may use it in a manner to further their own business.



### The owner's position

An owner needs to consider its disposal strategy before it enters into an HMA. Whether the hotel is a short or long term investment, owners need to ensure that they are able to transfer with limited restrictions as and when required. The more restrictions placed on the owner's right to transfer, the greater impact such restrictions will have on the value of the hotel. In the case of a restriction on transfer to a competitor, the owner needs to consider how this will limit the pool of potential purchasers of the hotel. A wide interpretation of a hotel operator's (and its affiliates) "competitor" could exclude as potential purchasers not only large branded operators, but also may exclude investment funds (that may acquire a shareholding in an operator), owner/operators (i.e. a conglomerate who operates a small number of its own hotels), and operators of different types and classes of accommodation. Such a restricted market of potential purchasers may negatively impact the value of the hotel and seriously hamper the ability of the owner to dispose of the hotel. Accordingly, owners should seek to push back on restrictions to transfer and, to the extent that the operator does require restrictions on transfers to a competitor, the owner needs to require the operator to define what a competitor means.



### The lender's position

Similarly to a hotel owner, a lender needs to ensure that it can freely transfer the hotel in the event of an owner default, in order that it can recoup the outstanding debt. Accordingly a wide definition of competitor will be of concern to a lender if it restricts the market for potential purchasers and lowers the value of the hotel, as this will increase the risk that the lender may not recover all of the debt. If there are onerous restrictions on transfer which will be applicable to the lender, then the terms upon which the lender is willing to lend may be less favourable and more expensive for the owner. These transfer provisions need to be taken into consideration in addition to the general lender protection provisions when considering the HMA from the lender's perspective.



### Negotiation consideration

The parties should consider if there are alternative options to having a restriction on transfer to a competitor. For example an investment fund, which needs flexibility to transfer as part of their investment strategy, may instead offer a right of first refusal on transfer which, if not exercised by the operator, permits the owner to sell the hotel without restriction (although the owner will need to ensure this does not unduly delay the sale process). Alternatively, an owner may require a right of termination of the HMA on sale in exchange for higher level of fees for the operator.

If the parties are not able to agree on unrestricted rights of transfer of owner, then they will need to consider who will be considered a competitor of the operator in practice and define this in the HMA. A competitor could be limited to an operator operating the same type and quality of accommodation, noting that this ideally would not include reference to all operator affiliates (as affiliates may have very different products over time which could effectively widen the definition to all hotel accommodation). The owner should also consider whether a competitor would need to be operating a minimum number of hotels and in a minimum number of or specific jurisdictions (i.e. a competitor is an operator operating a minimum of twenty-five hotels in over five jurisdictions).

Given the increasing number of investment companies that may both own hotels and have shares in hotel operating companies, hotel owners should also consider whether the definition of competitor would exclude parties with a shareholding in a hotel operating company under a certain level, i.e. 50 per cent, or would exclude a party who was not involved in the operation of the core business of hotel operation using centralised systems for reservations and marketing.



### Did you know

According to press reports, the proposed acquisition by Marriott International of Starwood Hotels & Resorts Worldwide will result in a combined entity with 1,071,096 rooms in 5,456 hotels<sup>1</sup>. The acquisition of FRHI Holdings Ltd (owner of the Raffles, Fairmont and Swissôtel brands) by AccorHotels will give AccorHotels an additional 155 hotels and resorts with 56,000 rooms<sup>2</sup>. The expansion of major hotel operators such as Marriott and AccorHotels, along with the increasing diversity in brands and accommodation type, means that owners and operators need to delve more deeply into who will be competing with their hotel and how competitors are defined.

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- 1 HotelNewsNow, "The 10 largest hotel companies by room count" November 19, 2015, <http://www.hotelnewsnow.com/Articles/28560/The-10-largest-hotel-companies-by-room-count>.
  - 2 HotelNewsNow "Accor to buy Fairmont, Raffles, Swissôtel" December 9, 2015 <http://www.hotelnewsnow.com/Articles/28748/Accor-to-buy-Fairmont-Raffles-Swissotel>.



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