

Hotels Resorts & Tourism

Newsletter

Global

BAKER & MCKENZIE

July 2007

In this issue

Specific Involvement

Operators and Brands

Ten Hot Management Agreement Issues in Asia

[Frenetic activity by operators](#)

[Operators like Management Agreements and dislike Leases](#)

[Without cause termination is harder to achieve](#)

[Getting harder to terminate an underperforming operator](#)

[Owner sale provisions](#)

[Financiers](#)

[The retail market](#)

[Leveraging brand value](#)

[Brand standards](#)

[Movement away from agency relationship](#)

Ten Hot Management Agreement Issues in Asia

What is this article about?

In this article we set out what we consider to be the current ten hot issues in management agreements in Asia. The photos in this article show some of the hotels that the Sydney office has worked on, some recently and some not so recently (but as they are all our children we love them equally). It should not be assumed that there is any correlation between a particular photo and the text of the article which surrounds where the photo appears.

What are our views based on?

Our views are based upon:

- experience gained acting on deals in eleven jurisdictions which involved approximately nine global/multi jurisdictional operators and 19 brands; and
- experience gained from hotel specialists in Baker & McKenzie offices around the world.

We have accessed Baker & McKenzie's global reach and in particular over 150 HRT practitioners in approximately 60 offices globally.

Specific involvement

In the last 12 months we have worked on agreements in:

- Australia
- China (including Hong Kong and Macau)
- Fiji
- India
- Indonesia
- Japan
- Maldives
- New Zealand
- Singapore
- Thailand
- Vietnam

www.bakernet.com

©2007 Baker & McKenzie
All right reserved

[Back to top](#)

 [Print document](#)



Swissôtel
Singapore

The Operators and Brands

In the last 12 months we have dealt with the following operators and brands:

- Accor (Sofitel, Novotel and Ibis)
- Fairmont Raffles (Raffles, Swissôtel)
- Four Seasons
- Hyatt (Grand Hyatt)
- InterContinental (InterContinental, Crowne Plaza, Centra and Holiday Inn)
- Marriott (Renaissance)
- Mirvac (Sebel, Citigate, Quay West)
- Shangri-La (Shangri-La)
- Westin (aloft, Westin)



Grand Hyatt
Melbourne

The Ten Hot Management Agreement Issues in Asia

In our view the ten hot issues are:

1. **Sign Them Up:** There is frenetic activity by many operators in many jurisdictions to sign up management agreements.
2. **No Leases Thanks:** Operators like management agreements and dislike leases.
3. **In For The Long Haul:** It's getting harder to prematurely terminate an operator without cause.
4. **No Termination:** It's also getting harder to terminate an under performing operator.
5. **Not For Sale:** Owner sale provisions are getting tighter and are subject to increasing operator discretion.
6. **Let's Bind Financiers:** Operators are increasingly keen to bind financiers.
7. **The Retail Market:** Developers are moving heavily into the retail market (eg Condo Hotels) with enhanced risk.
8. **Brand Leverage:** Savvy operators are leveraging brand value (eg branded residences and brand partners).
9. **Brand Standards:** The Brand Standard is increasingly becoming the benchmark for CAPEX spending.
10. **Agency Out:** Operators are moving away from "agency" relationship with owners to minimise complications (eg obligation to disclose "secret" profits).



aloft Hotel
Sydney



La Veranda
Phuc Quoc, Vietnam

We will now discuss each of these in greater detail.

1. Frenetic activity by operators

Most major multi-jurisdictional operators have unprecedented expansion plans throughout Asia. However, this does not mean that operators are prepared to take a soft approach to negotiation. In fact, we are seeing just the opposite.

2. Operators like Management Agreements and dislike Leases

With management agreements the business risk relating to the operation of the hotel usually rests with the owner of the hotel. On the other hand, with leases, the business risk usually would rest with the tenant which, in a hotel context, would mean the hotel operator.

Generally speaking, operators are risk averse and are resisting being responsible for any aspect of the business risk associated with a hotel. Interestingly leases remain the norm in Japan, and this will be discussed in the next edition of the Newsletter.

Usually a hotel operator's desire or willingness to take on business risk in relation to a hotel is directly proportional to the attractiveness of the hotel to the operator. For example, if a hotel is perceived to be a "trophy" hotel, then an operator will be more likely to accept a requirement to take on business risk. Allied to this is the fact that predictability of revenue and profit tends to be fairly strong with a "trophy" hotel.

On the other hand, if the hotel is just another "flag on the map" with no particular strategic significance to the operator then the operator's desire to take on business risk will be minimal to non-existent.

An operator's desire to take on business risk can result in the operator being prepared to accept the entire business risk of the hotel for the period of its contractual arrangements with the owner. Alternatively, it can be prepared to accept only a degree of the business risk. Examples of this are:-

- providing a specified income guarantee for the hotel for all or part of the period of its contractual arrangements with the owner;
- providing an income guarantee which is limited to the fees which would otherwise be payable to the operator for the period that the guarantee remains in place.

These income guarantees can either be provided as an absolute commitment on the part of the operator or on a "stand aside" basis. In the former situation if a guaranteed payment is made then there is no ability on the part of the operator to have the monies refunded to it at some later stage. On the other hand, in a "stand aside" situation the monies are effectively loaned by the operator to the owner and are capable of being repaid to the operator in certain circumstances over the remaining life of the contractual arrangement.

As a general comment, operator funding is probably the most expensive money available in the market place. As a condition to providing such funding, operators will normally require the owner to make concessions in relation to other significant commercial terms of the management arrangement such as the

term of the agreement, the basis upon which the operator can be terminated for under-performance or the fees payable to the operator.

A lease should not be confused with a hybrid which has come to be known as a “man-lease”. A man-lease is meant to be a creature which, whilst taking the shape of a lease, has many of the commercial terms of a management agreement. In other words, under a man-lease the risk of hotel operations usually remains with the owner. Man-leases are used in certain jurisdictions such as Australia to deal with issues that arise under local law (eg tax laws).

Before leaving this topic it is relevant to note that hotel franchises are still relatively uncommon in Asia.



Rendezvous Hotel
Auckland

3. Without cause termination is harder to achieve

For operators, tenure is the name of the game. Operators want to ensure, to the maximum extent possible, that when they enter into a contractual arrangement with an owner, little scope exists for the agreement to be terminated before its full term has expired.

Traditionally, owners were able to negotiate provisions which entitled them to terminate at any time during the life of the management agreement without cause. It is becoming extremely unusual to find such provisions except in relation to “trophy” properties. If an operator is prepared to agree to such a provision then the amount of the termination fee required is becoming increasingly larger. Previously, operators were prepared to agree to a termination fee which was usually an amount which equated to three to five years’ fees. We are now witnessing situations where the fee that the operator requires in consideration for giving the owner this right is the discounted present value of the management fee income stream for the balance of the term.

It has also been relatively common to find a provision which allows an owner to terminate the management agreement on the sale of the hotel. Whilst these provisions continue to be significantly more common in management agreements than without cause termination provisions, operators are hardening their position and the opportunity to end up with such a provision in a management agreement is becoming that much more difficult to achieve. If an operator is prepared to agree to such a provision then more often than not it is not available to the owner for an initial period (usually up to five years from the commencement date of the management agreement).

So any form of termination provision which allows an owner to terminate without cause on payment of compensation, either at any time, or on sale, is becoming increasingly difficult to negotiate and if an operator is prepared to agree to such a provision it is normally accompanied by very significant concessions or payments.



InterContinental
Paris



W Hotel (renamed Blue)
Sydney

4. Getting harder to terminate an underperforming operator

Traditionally, management agreements have contained performance based termination clauses. The usual clauses were based on either:

- actual performance to budget; and/or (usually “and”)
- REVPAR in relation to the hotel’s competitive set.

The usual actual to budget provision provides that the owner will be entitled to terminate the management agreement without compensation if actual performance falls below budgeted performance by a specified percentage (which is normally in the 80%-90% range).

The actual performance to budget test has the following problems:

- The inherent subjectivity of the budget setting process (and the key role that the operator usually has in relation to the preparation of the budget).
- The fact that operators will normally require an initial contract period where the test does not apply.
- The fact that operators require the test to be breached in at least two consecutive years.
- It is usually subject to Force
- Majeure (eg war, tempest, terrorism) and other carve-out provisions.
- Operators normally require the right to “top up” on one or more occasions with the result that the clause ceases to allow the owner to terminate.

The usual REVPAR test provides that the owner will be able to terminate should the revenue per available room (REVPAR) fall below a specified percentage (usually in the 80%-90% range) of the average REVPAR for a number of specified hotels which form the competitive set for the hotel.

The REVPAR test has the following problems:

- Difficult to identify the competitive set (particularly in developing markets or with a new built hotel where the opening date for the hotel may be a significant number of years into the future).
- Difficult to agree on changes to the competitive set.
- Difficult to identify meaningful or accurate comparative REVPAR data.
- Difficult to agree on the identity/powers of any process of dispute resolution which the owner and operator can access if they are unable to agree on any of the above.

In our experience the current crop of termination provisions which relate to under-performance contain so many qualifications and carve-outs that, in a practical sense, owners are unable to terminate the operator under these provisions.

5. Owner sale provisions

These provisions allow for changes in the economic control of the hotel either by a sale of the hotel itself or a sale of majority interest in the ownership interests of the entity (eg company, trust or limited partnership) which owns the hotel.

It is usual for operator approval to be required on an arms length sale. Increasingly this is creating issues where the owner or the ultimate holding entity of the owner is publicly listed. In such circumstances it is impossible for the owner to prevent a change in control (eg as a consequence of hostile takeover) and hence find itself potentially in breach of the management agreement and subject to a claim for damages.

Operators increasingly are requiring some form of first/last right of refusal in relation to such sales. These clauses can create significant complications where it is sought to conduct a sale using some form of tender or auction process (most potential purchasers will lack the enthusiasm to incur the time and expense to undertake due diligence in relation to the hotel if the owner is required to deal with the operator in some fashion before it is legally entitled to sell to one of the potential purchasers).

Conversely, and amidst the current buyout activity, operators are seeking to maximise the ability to acquire or be acquired without any need to consult with, or seek the approval of, the owner. Accordingly, from an owner's perspective, the operating company it is dealing with on the day the management agreement is signed, may become a different operating company during the life of the management agreement with the owner being powerless to do anything about it.



Citigate
Melbourne

6. Financiers

Operator attitudes to non-disturbance agreements (NDA) are definitely hardening.

An NDA is an agreement between the owner, the operator and the owner's financier which brings the financier into a contractual relationship with the operator. The purpose of an NDA is to prevent the financier from dealing with the hotel in a manner which ignores the contractual rights the operator has under the management agreement. Also, the financiers may want to ensure the operator continues to manage the hotel if the owner defaults under its financing arrangements. An NDA can adversely impact on the financier's ability to maximise the sale value of the hotel because the NDA usually requires the financier to sell the hotel subject to the management agreement (when a higher sale price could be achieved through a sale unencumbered by the management agreement).

Operators increasingly are placing an absolute obligation (as opposed to using reasonable efforts) on owners to obtain an NDA in the operator's prescribed form, even if the operator was not providing any financial contribution to the owner. Until recently it was relatively easy to convince an operator not to require an NDA in circumstances where only on-going management fees were at risk.

As a consequence of the operator's hardening position, negotiations are focussing on identifying circumstances where the operator would be prepared not to insist upon an NDA. These "carve-outs" can take a variety of forms but

relate to the identification of the financier being an institutional bank or other form of institutional organisation and a specification that the loan to value ratio be below a specified percentage (usually around 75%).

Financiers too are adopting a harder line in relation to the obligation for an NDA and the provisions which the financier wants in the NDA to protect its position. Needless to say, the positions taken by the operator and the financier are usually diametrically opposed and can end up leaving the owner (and its tireless legal advisers) as the “meat in the sandwich” trying to broker a compromise between two warring factions.

NDA’s are also an issue when viewed from the perspective of the sale of the hotel, as the management agreement not only imposes an obligation on the initial owner’s financier but any financier to a future assignee of the management agreement. Care needs to be taken to ensure that the terms of the NDA

7. The retail market

Condo hotels are exploding (in popularity) throughout the Asia-Pacific region. The term “condo” is an abbreviation of the term “condominium” which is an American expression usually referring to holiday accommodation. The term “condo hotel” usually refers to a hotel complex where ownership of individual accommodation units has a separate title and is sold to individual “mum and dad” investors. These apartments are then leased back to or managed by an entity associated with the developer which in turn enters into a management agreement with the operator. Alternatively, but more rarely, the lease-back arrangements are directly with the operator.

The emergence of condo hotels has moved the hotel industry solidly into the retail investor market. Developers and operators of condo hotels in most jurisdictions are required to deal with an extensive range of laws, breaches of which attract both civil and criminal liabilities, and which do not apply in circumstances where the hotel is owned solely by one party such as a high net worth individual, a fund or an institution.

For more information on this specialised class of hotel product, please refer to the article on condo hotels in an earlier edition of the Newsletter (if you would like us to forward a copy of this Newsletter to you then simply send us an email).

8. Leveraging brand value

Savvy operators are leveraging brand value in a number of inventive ways including:

- branded residences (these normally form part of or adjoin a hotel operated by the operator. It is the parties’ intention that the availability of the brand will attract a higher sale value for each of the residences than would otherwise be the case); and
- brand partners (these are “brand” entities that the operator wishes to affiliate with to enhance the value of the operator’s brand. Examples include car companies, perfume companies, apparel companies etc).



Park Hyatt
Sydney

Brand leveraging potentially imposes restrictions on owners which need to be understood:

- in the case of branded residences, operators seek to impose significant controls on the developer's conduct of the sale campaign; and
- in the case of brand partners, hotel operators may require owners not to advertise in the hotel or otherwise deal with brands which are in competition with not only the operator's brands but the brands of its brand partners. This can be particularly difficult when the prohibition remains in place for the term of the management agreement and at the outset the identity of the brand partners is unknown or likely to change over time.

9. Brand standards

Increasingly the operator's Brand Standards for the type of hotel with which the hotel is intended to be branded are the benchmark for CAPEX expenditure (as opposed to determining CAPEX expenditure by reference to the hotel's competitive set or some other form of external comparison).

This approach raises a number of compliance issues for owners which can be illustrated as follows:

- The first example is what I would call the "plasma screens" upgrade. Let's assume the owner has recently installed television sets into each of the rooms at the hotel with the remaining depreciable life of, say, four years. Shortly after the television screens are installed the operator's Brand Standards for this hotel are amended to provide for plasma screens. The management agreement, in these circumstances, needs to be drafted in such a manner to ensure that the transition to plasma screens can be effected over time taking into account the remaining useful life of the television sets. There are many examples of management agreements currently in operation which potentially could allow an operator to insist that the conversion take place immediately upon the change to the Brand Standards with a substantial additional cost payable by the owner.
- The second example is what I would call the "public area wiFi dilemma". Let's assume that the Brand Standards for the relevant hotel require wiFi in the public areas which attracts a substantial installation cost. Some management agreements we have been involved with require the operator to take into consideration the economic benefit of this expenditure – particularly in circumstances where such a facility is not provided by the hotel's competitive set and currently is not considered by the hotel's potential consumer base to deserve a room rate hike commensurate with the cost of installation of the wiFi. This is usually not a case of not expending the funds on wiFi at all, but more a case of not expending funds yet.

Increasingly management agreements provide for termination by the operator in circumstances where the owner fails to comply with the Brand Standards. Whilst such a provision is understandable from an operator's point of view to ensure brand integrity, this obligation can be particularly difficult with condo hotels as discussed in our previous newsletter referred to above (due to the difficulty in collecting CAPEX funding from retail investors).



Westin Hotel
Sydney

Before leaving this topic it should also be noted that there remains an on-going conundrum as to how to adequately and effectively deal with issues and disputes which arise between owners and operators as to whether Brand Standards have been complied with in a particular respect – particularly when failure to comply may result in termination of the management agreement by the operator.



Shangri-La Hotel
Sydney

10. The movement away from agency relationship

Traditionally the relationship between an owner and an operator under a hotel management agreement was based on agency. The operator managed the hotel as agent for the owner. In a significant number of jurisdictions the law imposes what is known as “fiduciary” obligations on an agent. These obligations would not apply if the agency relationship did not exist. In particular, the law imposes an obligation on the agent not to make any profit from its position as agent except profit which is properly disclosed to its principal.

Over the last ten years there have been a number of court cases, particularly in North America, where owners have sought to challenge the fact that an operator has made an undisclosed profit (eg through dealings with related parties or rebates etc arising out of purchasing arrangements).

This concept is particularly troubling to international hotel operators not so much because they want to make an undisclosed profit from their role as manager of a hotel but because their operations have become so complex that they cannot be certain that in all instances no aspect of their financial arrangements could be considered to be an undisclosed profit.

Some operators have sought to deal with this by putting in the management agreement words to the effect that any profit generated in such circumstances is deemed to be disclosed and therefore free from attack. It is not entirely clear whether this approach effectively deals with the problem from the operator’s perspective.

Some operators have adopted a different approach and have taken the significant step of converting their relationship with the owners from a relationship based on agency to a relationship based merely on contract. In most jurisdictions, mere contractual relationship generally does not attract fiduciary obligations in the same way that an agency relationship does.

From an owner’s perspective the change from agency to contract takes away a basic protection (ie the operator’s inability to make a secret profit) and so consideration needs to be given to what wording needs to be inserted into the management agreement to ensure that problems do not arise between the owner and the operator over the term of such an agreement.



Graeme Dickson
Global Practice Leader
+61 2 8922 5228
graeme.dickson@bakernet.com



Westin Auckland, Lighter Quay
Auckland

One of our recent assignments in New Zealand

Overlooking Auckland's Viaduct harbour, The Westin Auckland – Lighter Quay by Melview Developments marks the 'crowning glory' of their prestigious Lighter Quay Development.

The hotel sits with some of Auckland's most luxurious and premier apartments, surrounded by water with an internal water way and private marina around which the hotel and apartment buildings are arranged.

The luxury 5 STAR Westin Auckland finally completes the Lighter Quay development for Melview, offering both residents and visitors Auckland's best hospitality facilities.

Melview Developments is regarded as one of New Zealand's most progressive and visionary property developers renowned for their investment in the tourism and hotel industry which they believe to be the future of New Zealand's economy.

Hotels, Resorts and Tourism group – global contacts

Awards and Accolades

Asia Pacific Law Firm of the Year

PLC Which Lawyer? Awards
2007, 2006, 2005

Top 10 law firm

American Lawyer – Global 100
2007, 2006, 2005, 2004

Ranked No. 1 Global Law Firm

PLC Global 50 World Rankings
2006, 2005, 2004

Tax & Trusts Law Firm of the Year

Asian Legal Business
2007, 2006, 2005, 2004

China Client Choice Award

International Law Office Awards
2006, 2005

Indonesian Law Firm of the Year

IFLR Asian Awards
2007, 2006, 2005, 2004, 2003

**Ranked No. 1 legal adviser by
Widest Coverage and Total Number
of Deals**

M&A Asia - 2004, 2003, 2002

Best International Law Firm

Australian Law Awards - 2003

Almaty

[Curtis Masters](#)
+7 3272 5099 45

Amsterdam

[Mark Bongard](#)
+31 20 5517 510

Antwerp

[Koen De Winter](#)
+32 3 213 40 40

Baku

[Daniel Matthews](#)
+994 12 497 18 01

Bangkok

[Anurat Tivaphorn](#)
+66 2636-2000 ext 4000

Barcelona

[Xavier Junquera](#)
+34 93 2060 820

Beijing

[Rico Chan](#)
+852 2846 1971

Berlin

[Ulrich Hennings](#)
+49 30 2038 7623

Brussels

[Arne Gutermann](#)
+32 2 639 3611

Budapest

[Geza Kajtar](#)
+36 1 302 3330

Buenos Aires

[Avelino Rolon](#)
+54 11 4310 2224

Cancun

[Reynaldo Vizcarra](#)
+52 998 881 1974

Caracas

[Alejandro Alfonso-Larrai](#)
+58 212 276 5046

Chicago

[Richard Cremieux](#)
+312 861 8898

Dallas

[David Glickman](#)
+214 978 3057

Frankfurt

[Georg von Franckenstein](#)
+496 929 908 250

Geneva

[Adrian Moore](#)
+41 227 079 800

Guadalajara

[Jose M Larroque](#)
+52 664 633 4310

[Fabian Monsalve Agraz](#)

+52 33 3848 5300

Hanoi / Ho Chi Minh City

[Frederick Burke](#)
+84 8 823 6238

Hong Kong

[Angela WY Lee](#)
+852 2846 1738

Jakarta

[Duane J Gingerich](#)
+62 21 515 4886

Juárez

[Jorge Ruiz](#)
+52 656 629 1306

Kuala Lumpur

[Brian Chia](#)
+60 3 2055 1999

Kyiv

[Serhiy Piontkovsky](#)
+380 44 490 7070

London

[Mark Henrick](#)
+44 0 20 7919 1733

Madrid

[Cecilia Pastor](#)
+34 912 304 500

[Isidro del Moral](#)

+34 91 391 5950

Manila

[Pearl Liu](#)
+63 2 819 4905

Melbourne

[Bruce Webb](#)
+613 9617 4255

Mexico City

[Gaspar Gutierrez-Centeno](#)
+52 55 5279 2909

[Alejandro Sepulveda](#)

+52 55 5279 2909

Miami

[Israel Alfonso](#)
+1 305 789 8917

Milan

[Pierfrancesco Federici](#)
+39 02 76231 379

Monterrey

[Jose M Larroque](#)
+52 664 633 4310

Moscow

[Adrian Moore](#)
+41 22 707 9800

Munich

[Stephen Spehl](#)
+49 89 55 23 8 205

New York

[Alayne F Serle](#)
+1 212 891 3772

Paris

[Olivier Mesmin](#)
+33 1 4417 5992

Rome

[Alfredo Lucente](#)
+39 06 44 063 215

San Diego

[Katherine A Bacal](#)
+415 576 3005

San Francisco

[Tiffany J Rose](#)
+1 415 576 3005

Santiago

[Leon Larrain](#)
+56 2 367 7041

Sao Paulo

[Esther M Flesch](#)
+55 11 3048 6940

Shanghai

[John Grobowski](#)
+86 21 6105 8588

Singapore

[Andrew Martin](#)
+65 6434 2507

Stockholm

[Mauritz Silfverstolpe](#)
+46 566 1 77 00

Sydney

[Graeme Dickson](#)
+612 8922 5228

St Petersburg

[Maxim Kalinin](#)
+7 812 325 8308

Taipei

[David Liou](#)
+886 2 2715 7238

Tijuana

[Jose M Larroque](#)
+52 664 633 4310

Tokyo

[Chris Hodgens](#)
+81 3 5157 2763

[Jeremy Pitts](#)

+81 3 5157 2720

Toronto

[Stewart D Saxe](#)
+416 865 6918

Warsaw

[Tomasz Ujejski](#)
+44 20 7919 1144

Washington

[Thomas J Egan, Jnr](#)
+1 202 452 7050

Zurich

[Joachim G Frick](#)
+41 013 841 231

For more information visit our website www.bakernet.com/tourism.

Data Privacy

If you would like your details to be added or deleted from our mailing list, please contact [Margaret Hammond](#) on +61 2 8922 5519.

Disclaimer

This publication has been prepared for the general information of clients and professional associates of Baker & McKenzie. You should not rely on the contents. It is not legal advice and should not be regarded as a substitute for legal advice. To the fullest extent allowed by law, Baker & McKenzie excludes all liability (whether arising in contract, for negligence or otherwise) in respect of all and each part of this document, including without limitation, any errors or omissions.

Baker & McKenzie International is a Swiss Verein with member law firms around the world. In accordance with the common terminology used in professional service organisations, reference to a "partner" means a person who is a partner, or equivalent, in such a law firm. Similarly, reference to an "office" means an office of any such law firm.