



# Operator consolidation's impact on hotel management contract clauses: Time for owner pushback!



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The recent -and likely continuing- wave of operator consolidations raises a number of legal/contractual issues for the hotel owner-operator relationship which should be raised or revisited by owners in negotiations. Some of these consolidation created issues include:

## **Brand dilution/de-emphasis**

Recent mergers (e.g., Marriott-Starwood) have resulted in the surviving company holding a number of overlapping market sector brands. There stands a real possibility of brand rationalization, with some of these competing Brands being disposed of, de-emphasized or phased out.

What to do if you are the owner of a property under a 25 year contract with a Brand which the surviving operator has decided to de-emphasize. Who is going to pay for any rebranding and should this not be a material contractual change allowing for a right to early contract termination or other remedies?

We now include brand de-emphasis clauses in contracts addressing this issue and the owner's rights in such event.

## **Sector vs. Brand specific non-competes**

Brands will argue that consolidation benefits Owners by bringing scale benefits economies and greater ability to compete vs. OTA distributors (as if share value interests and executive compensation were merely an afterthought). The reality, however, is that your former "Brand specific" territorial non-compete may be rendered obsolete by a merger with your operator now running a former direct hotel next door.

What if that former independent Brand competitor offers a better return to the operator than your hotel? Which hotel will the operator tend to emphasize and push business to via its distribution system?

Whilst one can argue for some synergy and scale savings arising from having both brands under one operator roof, there is no denying a potential conflict of interest here.

We are insisting that any territorial clauses be made not Brand specific but market sector specific to address this issue.

## **Termination without cause**

Consolidation, the growth of OTA booking channels and other factors have fundamentally changed the owner-operator relationship and made it less personal. Brands today focus on managing their brands than on managing your individual hotel. And whilst the operator you originally signed up with for a 25 year contract can through mergers and consolidation change beyond all recognition to the company you signed up with, you are expected to remain static and true to the original contract.

This is not reflective of the changing economic and industry realities. Nor does it reflect the market in other real estate spheres (e.g., commercial and retail leases) where term lengths of contracts are coming down and break clause rights increasingly standard.

An owner should have the right to an early termination without cause, albeit with reasonable compensation to the operator and not before some period after stabilisation (e.g. 5-7 years).

The world is (and Brands are) rapidly changing and this contractual right needs to be reflected in in today's management contracts.

## **Performance Tests that work**

The only time I have seen a performance test clause triggered was the result of currency fluctuations, and in that situation the operator was actually doing a good job! With the changing nature of the industry and distribution, the bog standard performance test percentage GOP and RevPAR to a competitive set metrics (inevitably skewed in the operator's favour) need to be tightened up and/or expanded.

Increasingly influential social media (e.g. TripAdvisor) ratings as well as minimum thresholds measuring how

much distribution is delivered via the Brand's own distribution system vs. OTAs can tell a lot about how well a Brand is performing with today's customer and ought to be factored in to performance tests.

Expect strong operator push back, but the time for revising and giving teeth to the standard performance test is long overdue.

### **Central marketing fees on OTA bookings?**

A Brand's value proposition to an owner is the strength of its Brand distribution system and they ask you to contribute to this via central service and marketing charges. Yet you pay the same CSM fees today as you did before the existence of OTAs: so you essentially are paying the OTAs a quite substantial fee AND the operator its fee for, admittedly, involuntarily outsourcing to the OTA the booking the Brand once did.

This very real dilution in what the Brand's distribution system delivers has not been reflected in the management contract fee structure and should be.

We try and carve out from CSM payments those fees attributable to bookings generated other than through the Brand's web site.

### **"McDonaldization" of scale**

Inevitably with size comes standardization, commoditization, and less personal attention or feeling of a partnership. Your property becomes in the wider scale less important to the operator, yet you pay the same as before.

In your contract, insist on the right to regular head office visits or clear and responsive channels to make sure your property and its issues remain high on the operator's agenda.

### **Consolidation restructuring costs**

With the various mergers it is inevitable that the operators will incur restructurings of the companies through whom they provide their management, Brand licensing, central services and related services.

This will involve amendments to your agreements and potential costs, including legal, possible registration fees and potential additional tax costs should the operator's new contracting entity be in a less favourable tax treaty jurisdiction.

Make sure that these potential costs are addressed any you as owner adequately protected.

## **Conclusions**

The hotels market, distribution modes and the owner operator relationship have changed dramatically, yet the management contracts governing this relationship have remained near static for now 50 years. This in part due to the operators' own self-interest, but also may be due to lazy lawyers who recycle the same standard contracts. And owners who do not collectively press their interests. Whatever the reason, the time for revisionism in the hotel management contract and negotiations is overdue.

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<http://www.hotelnewsnow.com/Articles/134463/Issues-raised-for-owners-when-operators-consolidate>