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In this issue

[Introduction](#)

[Structuring | Asset or Shares?](#)

[Vacant or Managed | What's in a Name?](#)

[Due Diligence | Scope and Planning](#)

[Warranties | None, Some or Kit and Caboodle?](#)

[Inclusions and Exclusions | What's Really for Sale?](#)

[Hotel Services | Access Rights and Other Issues](#)

[Employees | A Minefield of Options](#)

[Post-Exchange | Passing of risk, Hotel Operations](#)

[Adjustments | Timing, Arrears Collections and Books](#)

[Disputes | Think Ahead](#)

The Top Ten Decisions You Need to Make on Hotel Business Sale Agreements

Thinking of buying or selling a hotel? There's a lot of work required to organize or participate in a successful sale process and plenty of thought required as to how you should structure the transaction. Here are a few lessons we have learned.

Our experience in the buying or selling of hotels, whether it be in Australia or anywhere else in the world that we have done business, is that the same issues recur when making decisions about the sale process and then when drafting and negotiating your transaction documents. The purpose of this article is to examine some of the key transactional decisions that you need to make when buying or selling a hotel. Although we draw many issues from our Australian experiences, most of the issues are relevant to any jurisdiction in the world.

The top ten decisions that we discuss below are:

1. **Structuring:** asset or shares, tax and duty considerations.
2. **Hotel Managers:** pros and cons of buying with or without vacant possession and implications of management agreements.
3. **Due Diligence:** getting it right, setting materiality thresholds and managing the process.
4. **Warranties:** how many (if any) and how far should they go?
5. **Inclusions and Exclusions:** what's really for sale?
6. **Hotel Services and Access:** understanding access to the hotel, how the hotel gets access to its services and any impacts of mixed use developments.
7. **Employees:** offers of employment to transferring employees, adjustments for employee entitlements and key concerns.

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[Back to top](#)

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8. **Post-Exchange:** managing the post exchange process, passing of risk and maintaining the business through to settlement.
9. **Adjustments:** timing, scope, rethinking traditional processes such as the stocktake.
10. **Disputes:** thinking ahead and providing for appropriate dispute resolution to keep matters out of litigation.

Introduction

The sale or purchase of a single hotel asset or an entire portfolio is a complex, costly and potentially lengthy process, regardless of the scale of the transaction. However, it is possible to introduce significant efficiencies which can save time and reduce the complexity and cost.

There is no one element to which we can point as being solely responsible for a successful transaction result – rather, it is a combination of process design, considered drafting of the transaction documents and commerciality on the part of the vendor and the successful purchaser. We have used our considerable knowledge and experience to continually refine our services and bring innovation to the sale and purchase processes.

We do not suggest that the matters discussed in this article are by any means exhaustive of the issues that will arise during a hotel transaction, and some may not be directly applicable to your circumstances. What we have done is to share some of our experiences in important areas which, if not properly addressed, can increase costs, lead to price adjustments, or transactions being delayed or failing to proceed.

1. Structuring | Asset or Shares?

Fundamental to the design of many transactions is the desire of both parties to minimize adverse tax or cashflow consequences, whether those consequences arise from stamp duty, capital gains tax or a goods and services tax (GST) or other value added tax. While the impact of these costs will vary markedly between jurisdictions, they remain, in most cases, the first consideration of a vendor in deciding how an asset will be offered for sale, and for a purchaser in choosing how to acquire a hotel.

To a large extent where transfers of assets are involved, a purchaser will be restricted by the existing structures that are in place, unless they elect to pay potentially material additional costs to break from that structure. In the Australian context, one of the more common hotel ownership structures involves splitting ownership of the underlying hotel asset from that of the business. This is something which may need to be retained in an acquisition whether or not the purchaser has a need or desire to retain differentiated ownership in order to avoid the application of GST at a rate of 10% to the purchase price.

Structuring a purchase as a share sale will provide greater flexibility. In theory it should exempt the consideration paid from most tax implications other than stamp duty or other transfer fees payable on the share acquisition. Dealings with contracts and ongoing commercial arrangements at the hotel are also much simpler in these circumstances, as the contracting entity or entities remain the same before and after settlement. Provided that those contracts and arrangements do not contain restrictions on share sales, the time constraints that can arise from the need to obtain third party consents to assignments, are also substantially removed.

Both vendors and purchasers need to consider the following implications of share sales when evaluating the various transaction structures available:

- a) **Vendor concerns.** Unless the hotel-owning entity or entities are special purpose vehicles holding no other assets, a vendor may have to incur significant additional costs in transferring the assets into new entities to facilitate a sale. Alternatively, many special purpose vehicles with widely held shares or units have rules regarding sale or reallocation of those interests that are prohibitively expensive or which are administratively difficult. While these issues would not of themselves rule out a share sale, it is important to identify them at an early stage of a transaction so that potential purchasers can be made aware of the potential costs.
- b) **Purchaser concerns.** Aside from the potential to bear the type of costs referred to above, a purchaser's primary concern with a share purchase will be that, in becoming the owner of a company or trust, it inherits all past and present debts and liabilities of those entities, on and from the date of settlement. This leads to an additional requirement for a purchaser to satisfy itself not just in regard to the hotel assets, but also in relation to the owning entities and any historical activities or outstanding liabilities of those entities.

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Hotels are recognized and accepted as a class of property investment, with a place in real estate investment trusts (REITs) and more general property portfolios. REITs and other trust structures are often favored for holding commercial property, as a landlord receives rent "passively" and can remain structured as a non-trading trust with its profits not being taxed until distributed to unit-holders. However, a hotel owner with a hotel management agreement in place is deemed to be "trading" and will be taxed as a corporation, potentially for the entire financial year in which that ownership occurs.

Depending on the particular asset and circumstances, these tax implications may be able to be addressed through careful structuring.

It is important to consider the impact of structuring options on requirements for the timing of exchange, settlement and preparation of hotel management documentation associated with a hotel sale or purchase.

In general terms, purchasers and vendors should each give considerable thought to potential structures that may be suitable for any one transaction that they are contemplating. A vendor who has at least considered a variety of acquisition structures, some of the possible issues associated with each one and anticipated what a purchaser may require, will be in a much better position to deal commercially with prospective purchasers.

2. Vacant or Managed | What's in a Name?

Generally, a hotel sold with vacant possession will attract a higher price than a hotel subject to an existing management contract. However, the ability to obtain vacant possession is becoming increasingly rare with the global trend towards longer management terms and even greater restrictions on an owner's ability to terminate operators on sale (other than where significant termination fees have been negotiated). In most circumstances it is therefore necessary to consider the terms and implications of a hotel management agreement before conducting a hotel sale process. Among the more common of these implications are:

- a) **Right to approve sale.** Most management agreements include a right for the manager to assess and approve incoming purchasers to ensure that they have the requisite experience and financial background to support the hotel and the ongoing management relationship. This approval process, and the negotiation of the associated novation documents for the management agreement, often takes some time to complete. This is particularly the case where international managers are involved and head office approval needs to be sought. Vendors should assist in this process by giving their managers plenty of notice of a pending sale, and a potential purchaser should prepare this information well in advance of contract negotiations being finalized.
- b) **Brand standards.** Often overlooked, the brand standards of a major hotel operator are extremely important documents. In many cases they are coordinated and updated at an international level and then imposed on local operators. Brand standards and the changes to them can dictate the extent and frequency of capital expenditure and required upgrades to hotel fixtures and fittings. This can significantly affect cashflow and expenditure forecasts. While a prospective purchaser will rarely have an opportunity to inspect such a highly proprietary document, care should be taken to obtain as much information as possible about the brand standards specific to the hotel being acquired, and to form a view as to the extent those standards are incorporated into the existing management agreement.

- c) **Loyalty Programs.** Most international hotel operators run loyalty programs on a global or regional basis. These result in an expense to an owner as they generate free or discounted accommodation nights. These expenses will rarely be determinable from the records of the hotel itself, however potential adjustments between the parties and allocation of outstanding expenses between vendor and purchaser should be considered. At a minimum, enquiries should be made directly with the operator to gauge the extent of the possible cost.
- d) **Branding and Intellectual Property.** While an operator will, in almost all circumstances, retain ownership of the intellectual property associated with a hotel brand, there may well be business names for restaurants or shops in the hotel, website addresses and other intellectual property which is owned by the vendor and to which a purchaser needs to ensure it obtains title on settlement in order to operate the business. Less obvious items should also be considered, such as who owns the intellectual property in any guest databases held for the hotel and whether these can be transferred.
- e) **Non-Disturbance Agreements.** Where finance is being used to fund acquisition of a hotel asset, most operators will require the new hotel owner and the financier to enter into a non-disturbance agreement, under which the management agreement rights are protected in the event of the mortgagee exercising its power of sale. These documents can be particularly contentious and time consuming to negotiate, and the requirement to enter into such an arrangement should be identified as early as possible. Even if finance is proposed only at some future stage, a purchaser may wish to consider resolving an agreed form of document with the operator up front.

On the rare occasions that vacant possession is available, in the Australian context the most immediate issue can become the requirement for payment of GST on top of the purchase price. This is because what is being purchased at the instant of sale may no longer be a fully operating business (i.e. not a "going concern" for the purposes of Australian GST laws). Structures may be available to a purchaser to avoid this conclusion, particularly where a new management agreement is commencing from settlement. However, each matter needs to be considered in its particular circumstances, with relevance to the date on which settlement occurs and the timing for commencement of arrangements with the new or replacement operator.

GST IS NOT JUST A CASHFLOW ISSUE

Many of our clients initially assume that the GST payable on the acquisition of a hotel that is not a going concern is limited in its implications to an impact on short-term cashflow – i.e. it is paid at settlement and then recovered through the input-tax credit recovery system under Australia's GST laws. However, it needs to be remembered that stamp duty, which is payable on the transfer of land and assets at varying rates in all Australian states, is payable on GST inclusive consideration and is not recoverable from the government. To the extent transactions can be structured as a going concern and therefore not be subject to GST, this can save considerable additional outlay of stamp duty.

Any proposed hotel re-branding exercise following completion needs to be carefully considered and planned for in the transaction documentation. While vacant possession may be available, the previous hotel brand websites, email addresses and associated details should ideally be acquired by the purchaser or held by the vendor for the purchaser's benefit for an agreed period of time following settlement, to allow existing customers and service providers to be transferred across to the new brand. Don't forget the basic issues such as the purchaser having a license to come into the premises and prepare for the removal and replacement of branding and signs immediately after settlement.

Purchasers may wish to resist paying for or taking ownership of branded stationary, bathrobes, bathroom materials and associated stock where vacant possession is being obtained. Care is required in crafting the definition of "stock". However, in most situations a vendor will similarly not be able to use these items after settlement and will seek to recover the value of those materials from the purchaser.

In vacant possession situations, it becomes particularly important for a purchaser to bind the vendor to ongoing obligations with respect to operation of the hotel business (and procuring the operator to act accordingly) between exchange of contracts and settlement. This is more likely to be an issue with smaller operators who, in those circumstances, may not have the same incentive to continue operating the business at optimum levels, once termination rights have been exercised.

3. Due Diligence | Scope and Planning

Ultimately it is the extent, adequacy and availability of due diligence information which can determine the success or otherwise of a hotel transaction. In our experience, the most successful transactions are those which have the most extensive and complete due diligence information available, with respect to the underlying hotel asset, business and operator, before a purchaser begins substantive due diligence.

While prospective purchasers can and do have a role in improving the standard and coverage of due diligence information after the process has begun, responsibility for preparing and offering this information to market rests with the vendor in the first instance. This requires detailed planning, interrogation of key hotel personnel and collation of materials relevant to the hotel in an organized and easily digestible form. In our own practice, we begin such a process with a detailed checklist broken down into real property, business and corporate areas, which the vendor then uses as a prompt to compile the relevant categories of information and ask the appropriate questions of the operator, staff and consultants.

GO ONLINE! THE PAPERLESS DATA ROOM

Quite apart from the increasing environmental awareness and desire of many companies to encourage sustainable practices in all areas of business, online data rooms have become an almost essential aspect of any successful disposal of an international hotel asset. They provide a central location with 24 hour a day availability for all communications, requests for information, draft transaction documents and all relevant due diligence materials to be maintained. Provided they have been appropriately structured a good online data room will also allow for sections of the site to be "black boxed" so that access to communications with particular bidders can be restricted, and more sensitive materials can be prepared on the site but only released to successful bidders at agreed stages of the due diligence process.

Most law firms, many agencies and a few specialist online providers now have proprietary, secure online data rooms for these purposes which differ mainly in their accessibility and user-friendliness. Make sure you consider the following:

- Is the site security adequate? What policies/procedures are in place to protect against confidential information being disclosed or accessed by unauthorized parties?
- There should be rules regarding access and use of the data room that have been tailored to the specific transaction, confidentiality restrictions and all of the normal due diligence procedures regulating the online data room as you would expect if a paper room was being used.
- Ensure that access is monitored and access is removed when appropriate (e.g. unsuccessful bidders). Unless an alternative arrangement has been reached with the purchaser, access should be removed for all parties on settlement as well (presumably subject to a copy of the material in the data room being provided to the purchaser in electronic form at that time).
- Where hotel staff are given access to assist with updating information or responding to bidder Requests for Information, ensure that their access to sensitive documentation (employment contracts, etc.) is restricted.

A well-designed data room will be coupled with rules regulating access to and dealings with those materials. Matters as simple and detailed as the form and manner in which questions or requests for information can be asked by purchasers and their consultants and the timing that can be expected for responses to those questions, can greatly contribute to streamlining due diligence processes.

Confidentiality will be extremely important to vendors during this process, and access to a data room will usually only be granted once an appropriate confidentiality deed has been signed. The negotiation of these deeds can occasionally become an expensive and time-consuming road-block to a transaction, increasingly so where many prospective purchasers are asked to sign such a deed at the early stages of due diligence. It is important to streamline and standardize this process and if possible avoid using overly complicated or lengthy deeds.

Particularly in competitive tender situations, parties should also consider running (or requesting) a formal briefing session at some time after the first issue of the draft transaction documents. By this stage, substantial due diligence should have already been completed and the session can be used to discuss key concerns, the general approach taken in the transaction documentation and the expectations that the vendor will be applying to each of the bidders with respect to final bids.

Imposing sensible levels of materiality on this process is fundamental. Depending on the size of the assets being sold, a vendor may choose, for example, to disclose every relevant document or piece of correspondence, but only undertake to respond to purchaser requests for information if they relate to matters worth in excess of a certain amount or say, agreements with a remaining term in excess of 12 months. Both purchasers and vendors should seek to impose materiality restrictions on their own investigations and the extent to which they will pursue, query or ignore issues that are deemed to be non-material. This will have a direct impact on the cost and timing of a transaction and, ultimately, the level of detail and negotiation required in order to settle the transaction documentation.

4. Warranties | None, Some or Kit and Caboodle?

Among the more hotly contested sections of any transaction document, warranties can be a significant sticking point in a hotel transaction. The starting point depends largely on the commercial aspects of the transaction, the desirability of the asset and the timing within which a deal needs to be completed. Without any of these constraints, a vendor's ideal position is to give no warranties at all and a purchaser's to have both the opportunity for full due diligence and then everything, even-marginally relevant to the asset, subject to a warranty. This however, does not reflect the real world.

No matter how extensive warranties may be, a claim for breach of warranty is not only dependent on the original vendor still being in existence and having sufficient assets to pay, but without vendor cooperation it will almost always require expensive court action to enforce, and therefore be justified in only the most material of circumstances.

Warranties should really only be pursued for matters which are considered by the purchaser to be material. A purchaser would in most cases be well advised to pursue full disclosure on a particular issue and understand the extent of that issue, rather than simply rely on a warranty in relation to it. Once the issue is understood, a warranty may still be sought regarding a limit on its financial impacts, but this is done from an informed position rather than seeking general warranties to apply across the spectrum of hotel operations.

That said, parties quite rightly seek much broader warranties in a situation where insufficient due diligence material or opportunities for inspection of that material have been provided. It is more difficult for a vendor to refuse to grant warranties in a situation where the purchaser has been provided with only limited opportunity to make their own enquiries or to inspect records and information relevant to the hotel.

Similarly, where a vendor has provided quite detailed information to a purchaser on which they have relied in deciding to proceed with their investment, a vendor may be requested to provide a warranty with respect to the due diligence information itself – usually that such information is complete, correct and accurate in all respects.

CAPS, COLLARS AND RETENTIONS

With so much time spent arguing the substance of warranties, it is often easy to overlook the mechanisms behind them. A breach of a warranty by a party allows the other party to make a claim – failure to pay in accordance with that claim is then a breach of contract for which the injured party can take legal action. As discussed above, such action is expensive and unlikely to be taken unless the matter is material.

More importantly, the party standing behind the warranty must have sufficient resources to pay a claim.

Claims themselves take up significant administrative and legal time, and parties should be dissuaded from making minor or frequent claims to avoid incurring unnecessary expenses. The most common way of doing this is to provide a "collar", being an agreed minimum monetary limit (say \$100,000) which individual claims cumulatively have to reach before any one claim is allowed to be made. Vendors also may seek to impose a collar on individual claims, so that, for instance, no one warranty claim can be in respect of an amount less than \$10,000.

Positions on warranty caps, or total potential liabilities also differ, not surprisingly, between vendors and purchasers. A purchaser's starting position will usually be the purchase price, the vendor's position substantially less. The final position reached will depend on the commercial realities of the situation and the level of risk perceived to exist in the business.

5. Inclusions and Exclusions | What's Really for Sale?

There are two aspects to this question, both of which appear simple but which actually lead to quite a bit of confusion and post-settlement disputes in many hotel transactions:

- does the hotel owner or the operator own the fixtures, fittings and equipment (FF&E) in the Hotel; and
- is everything used in the Hotel operations actually owned by the vendor and is it being conveyed to the purchaser/s?

Ideally there will be an up-to-date hotel asset register which accurately records all of the FF&E. In practice, however, such a resource is almost never available and a purchaser needs to rely on its own investigations and the disclosures or undertakings of the vendor in the transaction documents. Where ownership of assets is split between the owner of the hotel and the owner of the underlying business, it becomes even more important to accurately identify where ownership of assets lies.

Items owned by the operator are most significant in vacant possession situations – failure to identify the fact that the hotel owner does not actually own the beds in the hotel can lead to some serious issues when possession is handed over and the operator takes its property away! Obviously these considerations also become relevant for the purposes of valuations.

Hotel owners and operators themselves often don't know (or in many cases have simply forgotten with the passage of time or changes in staff) that third parties own equipment or materials used in the day-to-day operation of the hotel. If these are not correctly identified and dealt with in the sale process, a purchaser can find themselves needing to acquire replacement assets or enter

into new agreements at significant cost after settlement. Some of the more common examples that we have come across are:

- photocopiers and major kitchen equipment being held under lease arrangements with third party suppliers;
- in-room or conference centre audio visual equipment being held via hire purchase arrangements or with ownership retained by the relevant movie-system owners;
- paintings and other artworks owned by a third party who has loaned works to the hotel for publicity or potential sale (often under informal arrangements direct with the hotel operator);
- retail lessees or third party restaurant operators owning significant items of fitout or equipment within their particular premises; and
- hotel managers having some of their personal furniture, equipment or artwork in the hotel which is removed in vacant possession situations.

6. Hotel Services | Access Rights and Other Issues

When dealing with hotels or indeed any type of real property, both vendors and purchasers commonly assume that the visible access paths to the property, whether by way of stairs, roads or pedestrian walkways, are either all within the ownership of the hotel or else are covered by appropriate legal rights to allow such use.

Many hotels are affected by agreements relating to the sharing of electricity, water and other services (particularly in mixed use developments), and providing for access to the hotel over Council-owned or third party land. In most circumstances, these agreements were entered into on construction of the hotel and may have been subsequently overlooked or forgotten. From a purchaser's perspective, unless these agreements are specifically disclosed, it is often only by conducting a survey of the property and considering the location of the services used by the hotel) that issues relating to access and services can be identified and raised with the vendor.

Some examples of issues with access and services are:

- the land onto which the fire exits of the hotel exit, is owned by a third party (and therefore at risk of being removed or developed in a way which restricts this access in future).
- occupants of an adjoining residential development built contemporaneously with the hotel hold rights to access and use the hotel gym and pool facilities (creating operational issues and requirements for access to be maintained).
- a hotel held by way of a lease, remains surrounded by unleased land owned by the landlord, over which no formal rights of access to the hotel exist.

- the main driveway of the hotel is constructed over Council land and subject to an agreement under which the hotel owner must maintain that Council land and assume liability for any public injuries or damage to property that occurs as a result of a failure to maintain.
- the hotel shares access to a carpark, part of which it utilizes for its guests, with neighbouring developments. As a result the hotel is required to contribute towards outgoings with respect to electricity, cleaning and capital repairs of the carpark as a whole.

The key to any of these scenarios is that appropriate preparation by a vendor or due diligence by a purchaser will be able to identify these issues at an early stage and avoid them arising during some of the more crucial commercial negotiations on the transaction documents. Where approvals are required for assignment of existing access agreements, the timing for securing these approvals needs to be built into the overall timeline for the transaction.

Despite all of the above, it is important to recognize that in some cases a solution to a particular issue may not be available, but these issues are precisely the ones which a vendor should identify and prepare for in advance so that they can be explained to a purchaser and a decision can be made in regard to the risk.

7. Employees | A Minefield of Options

Employee responsibilities and adjustment of employee expenses is one of the greatest costs associated with hotel operations and dealing with employees and their rights and entitlements is important. Care is required to ensure that the relevant transmission of business rules will properly apply to protect an incoming purchaser and outgoing vendor from employee claims for termination (and resulting redundancy payment obligations) that might otherwise arise on sale. This generally means that discussions in hotel transactions with respect to employees centre around two key areas – the adjustment of employee benefits and liabilities, and the purchaser's obligations with regard to offering employment to transferring employees.

There are a number of different categories of adjustment with respect to employees, some of which are always adjusted, some of which are rarely adjusted, and others which vary on a transactional basis. Of course, one way to avoid employee adjustments on a sale altogether is for the vendor to terminate all employees and pay out all remaining liabilities, with the purchaser then employing those employees afresh from settlement. Such a course of action would rarely be followed, however, as a number of additional costs and liabilities may arise, depending on the particular employment contracts and industrial instruments that apply. In general the categories of adjustment (some of which are more commonly adjusted than others) can be broken up as follows:

- accrued and pro rata annual leave entitlements;
- accrued and pro rata long service leave entitlements. The main variation from transaction to transaction in these entitlements is the method of calculation of long service leave;
- rostered days off and days in lieu;

- accrued sick leave; and
- worker's compensation, payroll tax and superannuation on-costs.

The discussion in relation to a purchaser's offer of employment to transferring employees is much more straight forward. Employment offers need to be made in such a way as to ensure that employees cannot claim they have effectively been made redundant. In Australia, the basis of this is that an employee is offered a job on generally equivalent terms to their employment before the sale, but vendors often seek to impose a higher standard on purchasers in order to provide some protection against redundancy claims by employees.

There can be substantial differences between a purchaser being required to offer employment to existing employees on "generally equivalent" terms and "equal or superior" terms, and purchasers will usually seek to avoid the latter requirement.

THE EMPLOYEE CLAUSE – KEY AREAS

We have set out below some of the key employee issues which, in our experience, need to be considered in any sale or purchase of a hotel business. These are based on the assumption that in most circumstances a hotel business owner will act as the employer for all hotel employees. In the rare situation in which this role is performed by the hotel manager, the process on sale will be simpler.

- **The process.** Employee meeting, provision of a required form of employment offer to the purchaser, timings for offers to be made and accepted.
- **Standard of offer.** The terms on which a purchaser will be required to offer employment to transferring employees.
- **Employees post-exchange.** Role of purchaser in approving new employees before settlement, ongoing obligations of vendor.
- **Adjustments.** Method of calculation, scope and timing.
- **Incentives and Bonus Schemes.** Quantify outstanding amounts, post-settlement adjustments and obligations of purchaser to assume schemes.
- **Industrial instruments.** Disclosure of all relevant instruments for the particular employees and purchaser awareness and compliance with all relevant provisions.
- **Superannuation.** Allocation of liabilities prior to and after settlement, purchaser membership of relevant industry super funds.
- **Redundancies.** Liability for redundancy claims and other employee disputes arising out of sale process.
- **Disputes.** Attempted resolution at vendor/purchaser level, referral of disputes to independent third party.
- **Post-settlement access.** Necessity for vendor to obtain access to employee records, requirement for ongoing cooperation with purchaser.

8. Post-Exchange | Passing of Risk, Hotel Operations

Simultaneous exchange and settlement of contracts involving the sale of a hotel are not common, and there will usually be a period following exchange during which various preconditions under the contract are satisfied, adjustments are calculated and the purchaser otherwise prepares for acquisition of the hotel.

In some jurisdictions, including a number of Australian States, a standard starting position is for a vendor to try and assign all risk of the hotel to the purchaser on the date of exchange. This means that a purchaser needs to have insurance in place from exchange and may be liable to comply with statutory notices issued with respect to the business, or other risks affecting the hotel, prior to the date of settlement. This position is rarely accepted by purchasers unless they are to have some active role in the business operations during this period or, for example, are preparing a new manager to take over the hotel from settlement, in the case of a vacant possession purchase.

In most circumstances, the vendor retains the risk but the parties may agree that certain matters, for example the issue of a statutory notice requiring significant capital works, may need to be jointly complied with by the vendor and purchaser. A purchaser's main concern during this period is that the hotel continues to run in accordance with standard practices and that the standard of the hotel business and assets remains at completion the same as at the date of exchange of contracts, subject only to fair wear and tear. This concept is reflected in varying forms in most transaction documents, with one of the key areas of dispute relating to the extent to which a vendor is required to replace or repair items in the hotel which fail, break down or are damaged beyond the standard of fair wear and tear during this period.

In other areas a purchaser will, quite rightly, seek to maintain a level of control over granting new contracts, carrying out capital expenditure works on the hotel, hiring new employees and other material business decisions made after exchange, that it may be required to inherit or adjust for on settlement. The variation in these arrangements generally centers around the monetary value of decisions above which the purchaser's consent is required, timing for the purchaser to issue a response, and whether or not a purchaser's discretion in this regard is absolute or in the form of a consent which cannot be unreasonably withheld.

APPROVALS AND PRECONDITIONS

A number of the issues raised above give rise to a requirement for approvals, novation deeds or other assignment documentation to be completed in order for a purchaser to complete its acquisition and be able to properly operate the hotel following settlement. It is during this post-exchange period that these approvals are sought and documented.

The requirement for these approvals must be identified during the due diligence process and addressed in the transaction documentation. To the extent that they are vital to hotel operations, purchasers would usually seek to make their satisfaction a precondition of settlement occurring.

Consideration needs to be given to the party that will control the process of seeking and finalizing these approvals and the consequences of failing to use all reasonable endeavors to do so. The following non-exhaustive list of common approvals/preconditions in the hotel context may assist:

- hotel operator approvals and novation of the relevant hotel management agreement;
- transfer of the Liquor License and if relevant, poker machine permits for the hotel;
- approval for the purchaser to invest in the hotel if it is a foreign corporation;
- novation or assignment of the service agreements for the hotel or equipment leases which are not in the name of the operator;
- novation or assignment of any tenancies within the hotel;
- approvals and assignment documentation from any government entities or third parties on whose land the hotel may be built or with who the hotel business may have documented arrangements; and
- transfer of any relevant business names and intellectual property not otherwise held or owned by the hotel operator.

9. Adjustments | Timing, Arrears Collections and Books

In a similar vein to employee adjustments, adjustments at the broader hotel level (and we are talking here about hotel business adjustments, not the more straight-forward asset adjustments relating to land tax, rates and the like) can be complex and vary from one transaction to the next. The structure of the particular hotel business and the extent to which the hotel business owner takes an active role in supervising and calculating hotel expenses, will also affect the way in which these adjustments are carried out. For simplicity, we have set out below a number of bullet points representing the common questions that need to be asked about adjustments, together with some of the primary heads of adjustment that we see in most, if not all hotel transactions:

- **Timing.** Will all adjustments be carried out on the settlement date? There are a number of options available. Everything can be adjusted on settlement, including by way of estimate for those matters which are not finally known at that time, and a readjustment only occurs later if the estimates are incorrect by an agreed percentage. Alternatively there can be two adjustment dates, one on settlement and another 30 to 60 days later for all other items which were not previously known with certainty.

- **Prepayments, Accruals and Capital Expenditure.** These cover amounts which the vendor may have paid in advance for services to be rendered or goods to be received after settlement, advance deposits or payments accrued by the vendor for services it will supply after settlement, and any capital expenditure which may be incurred by the vendor between exchange and settlement, for which the purchaser has agreed to provide reimbursement.
- **General Business Expenses and Income.** These are normally calculated on the basis that the purchaser receives all income and incurs all expenditure from the day of settlement and the vendor receives all income and bears all expenses prior to that time. These will include the employee adjustments, tenancies, service agreements and all other general categories of income and expenditure.
- **Guest Ledger and GST Issues.** The parties need to determine who will receive the income from the guest ledger for the night of accommodation preceding settlement, what happens to funds received from late checkouts on the day of settlement, and who bears the expenses of cleaning the rooms for these guests. Care needs to be taken in relation to invoicing arrangements for guests staying in the hotel that span the settlement date, as the liability for paying GST or other value added tax on accommodation will rest with the party issuing the guest invoice. Adjustments need to take this issue into account.
- **Arrears.** Will the purchaser buy out all debts and arrears of the business or simply undertake to assist the vendor with recovering those debts after settlement? If a cooperative approach (the more common method) is agreed, then how long will that cooperation continue for? When payments are received from debtors, does the purchaser attribute those monies first to debts owing to it and then to debts owing to the vendor?
- **Collections and Records.** Following completion, the business will continue to receive money owing to the vendor and the vendor may continue to receive money owing to the purchaser – how will this be dealt with and will there be a time limit on how long each party has to continue accounting to the other? To the extent the vendor needs access to the hotel books or employees following completion (i.e. to complete its tax and accounting records), consider the terms on which that access will be granted, the cost of any such access and the maximum period for which access must continue to be allowed.

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RETHINKING THE STOCKTAKE

The settlement stocktake is often one of the more costly and inconvenient aspects of a Hotel sale for vendors and purchasers alike, both practically and in the negotiation of clauses governing stocktake procedures and disputes. Despite this, parties often assume that it is a necessary and incidental inconvenience of the sale process. In reality, there is almost always sufficient information available to both parties to reach agreement on a genuine pre-estimate of stock value. This then becomes a very simple pre-agreed figure for adjustment to be inserted into the sale agreement.

Most parties can get comfortable with this departure from the traditional stocktake approach provided that:

- the vendor is obliged to maintain those levels of stock between the date of exchange and settlement;
- the vendor is obliged to operate the Hotel in the ordinary course of business; and
- where significant levels of stock are involved, a purchaser has the right to revisit the stocktake figure in post-settlement adjustments, where stock values are found to be, for example, 5% or more lower than the amount paid.

10. Disputes | Think Ahead

As a final and brief point, parties often either assume a sale process will flow smoothly once contracts have been exchanged, or at the other extreme, assume the worst and that in the case of any dispute, they will simply proceed to court.

The reality is, there will almost always be matters under a contract about which the vendor and purchaser have some form of disagreement, and there should be an appropriate mechanism in the contract documentation to deal with that situation. Such clauses and the process of parties negotiating and agreeing on their content, provide a strong disincentive from disagreements escalating to the point that the clauses are actually activated.

One of the most practical techniques in this regard is to build into a dispute resolution clause a requirement for the parties to refer any matter deemed to be an official "dispute", to the CEO or General Manager of their respective organizations. This should be a required first step before the involvement of a third party expert or any ability to take the dispute to arbitration or into the Court processes. In practice any issues which do not have material financial impacts will be negotiated to a resolution rather than taking them to such a senior level.

Obviously there will be some matters, particularly in relation to adjustments, which require input of a technical nature and which may not otherwise be able to be agreed between the respective senior officers. To the extent an independent expert is then given the ability to determine that dispute, parties need to decide whether that decision will be final and binding or capable of appeal to the courts. An appropriate middle ground may be to make all decisions final and binding except for those which have a financial impact in excess of a significant amount of money, at which stage parties can elect to appeal that decision, provided such election is made within a defined time period.

Awards and Accolades

Real Estate Deal of the Year for the InterContinental Hotels Group / All Nippon Airways operating joint venture partnership

ALB Japan Law Awards in 2007

Ranked No. 1 Firm

PLC Which Lawyer? Top 20 Firms (4th Consecutive Year) in 2007

Asia Pacific Law Firm of the Year

PLC Which Lawyer? Awards (3rd Consecutive Year) in 2007

Top 10 Law Firm

American Lawyer Global 100 in 2007

Highly Recommended Global Real Estate practices in 9 countries:

Argentina, Belgium, China, Hong Kong, Hungary, Poland, Russia, Singapore and Ukraine

PLC Which Lawyer? Yearbook in 2007

Recommended Global Real Estate practices in 9 countries: Australia, Germany, Italy, Japan, Mexico, Spain, Sweden, Switzerland and Venezuela

PLC Which Lawyer? Yearbook in 2007

Leading Law Firm for Real Estate in Hong Kong and China

Chambers Global in 2007

Tax & Trusts Law Firm of the Year, 4th Consecutive Year

ALB Southeast Asia Law Awards in 2007

Singapore M&A Deal of the Year

ALB Southeast Asia Law Awards in 2007

Deal of the Year for the structured sale by Harilela Hotels of W Hotel in Sydney

17th Asia Pacific Annual Hotel Investment Conference in 2006

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[Back to top](#)