

## Ten things to know about hotel management agreements in Australia

October, 2022

### Why do I care?

The tourism sector both in Australia and internationally has been hit particularly hard by the COVID-19 pandemic. As restrictions on domestic and international travel continue, many hotels are experiencing substantial losses in revenue.

The hotel management agreement (or **HMA**) is a nuanced and central feature of the operations and financing of any significant hotel. As such, understanding how the HMA works is critical to any recapitalisation, work-out or restructuring of a hotel's operations and capital structure.

### Need to know

- The relationship between a hotel owner and hotel operator is generally governed by the HMA.
- A HMA structure is relatively unique when compared to other types of property related businesses (including very long duration).
- Generally, the assets and business risk sits with the owner but the owner's ability to control the operator's actions is extremely limited.
- For financiers, there is often a non-disturbance agreement (**NDA**) in place with the owner's financier, which mandates that the financier (and any receiver appointed by the financier) acts in accordance with the provisions of the HMA.
- A clear understanding of the relationship between the owner and operator is vital for assessing the ability to influence and potentially fund the operating performance of the hotel and maximise its sale value.
- Advice from lawyers with expertise and long experience on HMAs is fundamental to maintaining ongoing hotel operations and preparing for and maximising the sale price.

## 1 Common structures

There are a number of structures available for the ownership and operation of a hotel. A number of hotels are satisfactorily operated by their owner. However, it is more common than not for the owner to appoint an operator, and the vast majority of professional operators are multi-jurisdictional chains (such as InterContinental, Marriott and Accor).

The relationship between an owner and operator is generally governed by the terms of a HMA. Whilst there are other ways to fashion the relationship between owners and operators, such as management leases or franchise agreements, the HMA constitutes the norm in Australia and most other parts of the world.

Ancillary documents such as NDAs, side letters, technical services agreements and emails reflecting operational practice are also common in a hotel context and one of the first things that should be done in a distressed scenario is to obtain a copy of the HMA and any ancillary documents relevant to the arrangement between the owner and operator, and carefully assess the ramifications for any restructuring, recapitalisation or sale.

An understanding of the owner's structure is also fundamental. Sometimes this is bifurcated such that separate entities own the land and the hotel business. Typically in this scenario, the land owner will grant the hotel business owner occupancy rights (in the form of a lease or licence) and the business owner and operator are parties to the HMA. Prudent operators will also ensure that there is a tripartite agreement in place to secure its tenure if the lease between the land owner and business owner is terminated.

## 2 HMAs

HMAs are usually long-term arrangements. Whilst the duration will turn on the nature of the asset and the negotiating power of the operator, it is common to see HMAs for "trophy" assets to be for a significant term (i.e., 10+ years).

The key feature of a HMA arrangement is that the owner owns the asset and retains business risk but the operator has almost exclusive control of the day-to-day operation of the hotel including the employees. In many but not all instances, the operator is the owner's agent.

Generally, the owner's ability to control the operator's actions is extremely limited and the matters which the owner has control over are specifically provided for in the HMA. Examples of decisions for which an operator may require the owner's approval would include whether to shut down business operations and if shut down when to re-commence such activity and on what basis.

Therefore, a clear understanding of the relationship between the owner and operator is vital for understanding the options and assessing the ability to influence both the operating performance and maximising any sale value of the hotel.

### 3 NDAs

Most HMAs place an obligation on the owner to obtain an NDA from any financier, which is generally an agreement between the operator, owner and the financier. The NDA will be a key document if any receiver is appointed by a financier to the owner, as it generally imposes stringent contractual obligations on the financier.

A HMA does not "run with the hotel land" the way a lease does and accordingly, in the absence of a NDA, a receiver appointed by a financier to an owner could potentially take possession of the hotel and effectively bypass the operator. In this scenario, the only recourse the operator has is to sue the owner for damages for breach of contract which may be of little value once the secured financier is paid out.

Equally, the NDA usually contains provisions designed to prevent the operator from seeking to terminate the HMA on a formal insolvency of the owner. This can be beneficial to "maintain business as usual" while the insolvency practitioner determines the approach it will take including positioning the hotel for sale.

Importantly, the existence of a NDA usually means that control of the hotel business remains with the operator, notwithstanding any formal insolvency of the owner, and may mean that the operator can exert significant influence over the process (as discussed further below).

The impact of a NDA must always be considered carefully - both in informal and consensual restructuring negotiations, and also in planning any formal restructuring. For instance, a NDA will often be directly relevant to vacant possession considerations (also discussed further below).

### 4 Bank accounts

As noted above, the day-to-day control of the hotel rests with the operator and not the owner. The operator generally has control of the bank accounts and has the right to spend the owner's money in accordance with an approved annual budget.

Depending on the specific provisions in the NDA, an insolvency practitioner appointed to the owner may be required to negotiate with the operator to effectively gain control of the bank accounts. The operator may be agreeable to relinquishing control if it is satisfied about the continuation of the HMA and that the insolvency practitioner will adequately fund the hotel.

### 5 Security documents

Careful consideration should be given to the loan documents and the supporting security documents to ensure that all aspects of hotel operations are subject to the security, for example, in addition to the land and the building also the furniture, fittings, equipment and contracts which are essential to the running of a hotel. Difficulties will arise where an insolvency practitioner does not have rights over all essential assets.

### 6 Employees

Most employees other than sometimes certain senior executives (such as the hotel general manager) are employed by the owner or an associated entity. However, it is common for operators to retain rights to hire and fire employees (subject to owner approval for senior appointments or dismissals) and to direct and control employees as part of everyday management.

Any recapitalisation, restructuring or sale strategy should include a workforce component, which is effectively communicated to the operator. This is significant given a receiver or administrator appointed to the owner may be personally liable for payment of wages and other employee entitlements; and to avoid workforce disruption, which may not be beneficial for operating performance or maximising the sale value of the hotel.

### 7 Compliance with brand standards

Under most HMAs, operators can insist on compliance with "brand standards" and require funds to be expended on the hotel in order to maintain those standards.

### 8 Confidentiality

HMAs often contain confidentiality restrictions which prevent disclosure of the contents of the HMA or operational information without the other party's consent to potential purchasers of the hotel. To ensure the process can be managed smoothly and the relationship with the hotel operator is not detrimentally affected, it is recommended to address confidentiality issues at the earliest opportunity.

## 9 Operator engagement

In a distressed scenario, the package of hotel documents (including the HMA and any NDA) should be considered in detail and a strategy developed as to how the operator - and the ongoing operations of the hotel - will be accommodated whilst any restructuring, recapitalisation or sale of the hotel is undertaken.

Constructive engagement with an operator will be crucial: they will obviously need to understand the process including the intention regarding retention or dismissal of any hotel employees and any ongoing funding for operations and capital expenditure.

Hostile relationships with the operator can not only adversely affect hotel operating performance but also any hotel sale process. Accordingly, setting the right tone should be designed to facilitate a productive relationship with the operator in the longer term.

## 10 Is a sale with vacant possession possible?

Maximising the sale value of the hotel may be the most important focus. The key issue here is whether the hotel can be sold with vacant possession (that is, termination of the existing hotel operator on sale of the hotel) and if not what impact this will have on the sale price. The sale of a hotel with vacant possession may attract a higher price as it would increase the pool of potential purchasers to include other hotel operating companies or alternative uses of the site.

At the outset, consideration should be given to whether the operator has any pre-emptive rights to purchase the hotel and, if so, the extent of those rights. A right of first or last refusal may complicate the sale process.

Whether or not the hotel can be sold with vacant possession will be determined by the HMA. It is rare for a HMA to provide for sale with vacant possession and if it does, there is normally a substantial fee payable to the operator (often calculated by reference to a number of years' fees that would otherwise have been payable).

If the hotel cannot be sold with vacant possession, generally HMAs do not allow a hotel owner to sell the hotel to a "competitor" of the hotel operator.

It is also common for owners to hold a right to terminate the HMA if the operator fails to meet defined performance measures detailed in the HMA. However, these provisions are often complex and, in our experience, it is very difficult for an owner to trigger the type of performance based termination provisions currently found in HMAs. It is also common for any performance test to be suspended during the continuance of a force majeure event (which may extend to a pandemic or epidemic) subject to satisfying notice requirements.

Aside from the issue of vacant possession and prohibitions on assignment to competitors, the sale of a hotel will give rise to a set of bespoke issues compared to other types of property classes as a transfer of business assets is also required. Whilst a discussion of these issues is outside the scope of this paper, matters such as transfer of business licences, dealing with the balance of any reserve accounts, continuity of employment and recognition of employee entitlements should be addressed (including to achieve going concern status) and it is highly recommended that you obtain legal advice from lawyers with extensive hotel expertise to ensure a smooth sale process.

### Why Baker McKenzie?

Baker McKenzie has a longstanding commitment to the travel and leisure industry in Australia and globally. We are uniquely placed to advise financiers and insolvency practitioners in this sector as the economy continues to experience the fallout from the COVID-19 pandemic.

Our dedicated Hotels, Resorts & Tourism Group comprises experienced corporate, real estate, taxation, stamp duty, employment law and construction practitioners with extensive knowledge of the hotels, resorts and tourism industry. Our Restructuring and Insolvency team is able to assist in relation to all aspects of distressed or insolvent transactions.

The size and diversity of our team enables us to deliver a complete, seamless and portable service, ranging from entire project management to smaller scale advice work, from any region of the world and tailored to meet our client's specific requirement.



## Real Estate



**Sebastian Busa**  
Partner  
+61 2 8922 5382  
[sebastian.bus@bakermckenzie.com](mailto:sebastian.bus@bakermckenzie.com)



**Graeme Dickson**  
Partner  
+61 2 8922 5228  
[graeme.dickson@bakermckenzie.com](mailto:graeme.dickson@bakermckenzie.com)



**Caroline Ho**  
Partner  
+61 2 8922 5295  
[caroline.ho@bakermckenzie.com](mailto:caroline.ho@bakermckenzie.com)



**David Jones**  
Of Counsel  
+61 2 8922 5319  
[david.jones@bakermckenzie.com](mailto:david.jones@bakermckenzie.com)



**Roy Melick**  
Partner  
+61 2 8922 5228  
[roy.melick@bakermckenzie.com](mailto:roy.melick@bakermckenzie.com)



**Dora Stilianos**  
Partner  
+61 3 9617 4285  
[dora.stilianos@bakermckenzie.com](mailto:dora.stilianos@bakermckenzie.com)



## Restructuring & Insolvency



**Maria O'Brien**  
Partner  
+61 2 8922 5222  
[maria.o'brien@bakermckenzie.com](mailto:maria.o'brien@bakermckenzie.com)



**Gavin Rakoczy**  
Partner  
+61 2 8922 5462  
[gavin.rakoczy@bakermckenzie.com](mailto:gavin.rakoczy@bakermckenzie.com)



## Employment



**Michael Michalandos**  
Partner  
+61 2 8922 5104  
[michael.michalandos@bakermckenzie.com](mailto:michael.michalandos@bakermckenzie.com)



**Brigid Maher**  
Partner  
+61 2 8922 5470  
[brigid.maher@bakermckenzie.com](mailto:brigid.maher@bakermckenzie.com)



## Banking & Finance



**Alastair Gourlay**  
Partner  
+61 2 8922 5365  
[alastair.gourlay@bakermckenzie.com](mailto:alastair.gourlay@bakermckenzie.com)



## Capital Markets



**Antony Rumboll**  
Partner  
+61 2 8922 5102  
[antony.rumboll@bakermckenzie.com](mailto:antony.rumboll@bakermckenzie.com)



**Lance Sacks**  
Partner  
+61 2 8922 5210  
[lance.sacks@bakermckenzie.com](mailto:lance.sacks@bakermckenzie.com)



## Tax



**Amrit MacIntyre**  
Partner  
+61 2 8922 5159  
[amrit.macintyre@bakermckenzie.com](mailto:amrit.macintyre@bakermckenzie.com)