Hotel News Now

Opinions

Issues raised for owners when operators consolidate

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When it comes to operator consolidations, hotel owners might find themselves enduring complications both legally and contractually.

By Scott Antel

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 brought up or revisited by owners in negotiations.

Here are seven issues created by operator consolidation.

1. Brand dilution/de-emphasis
Recent mergers such as 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.

2. Sector versus brand specific non-competes
Brands will argue that consolidation helps owners by bringing scale benefits to economies and greater ability to compete against online travel agency 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 agreement may be rendered obsolete by a merger in which your operator is now running a hotel next door that formerly was a direct competitor.

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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? While one can argue some synergy and scale savings arise 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 not be made brand specific, but instead 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 more on managing their brands than on managing your individual hotel. And while the operator, whom you originally signed a 25-year contract with, can through mergers and consolidation change beyond all recognition, 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 such as commercial and retail leases where term lengths of contracts are coming down and break clause rights increasingly standardize. 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 stabilization (five to seven 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 standard performance metrics (inevitably skewed in the operator's favor) need to be tightened and/or expanded. Increasingly influential social media ratings—as well as minimum thresholds measuring how much distribution is delivered via the brand's own distribution system versus OTAs—can tell a lot about how well a brand is performing with today's customer and ought to be factored into performance tests. Expect strong operator pushback, 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 by means other than the brand's website.

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, operators inevitably 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 additional tax costs should the operator's new contracting entity be in a less-favorable tax treaty jurisdiction. Make sure that these potential costs are addressed.

The hotel market, distribution modes and the owner-operator relationship have changed dramatically, yet the management contracts governing this relationship have remained near static for 50 years.

This, in part, is 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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