Hotel Lawyer: Franchise & Management Disputes in a Covid crucible

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Franchise and Management Disputes in the Time of Covid
by
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If you are reading this, you are almost certainly in the hospitality industry, and you are most likely in a financial and emotional distress. During trying times, hotel owners rely more than ever on their brands and managers – the professionals that owners engage to protect the multi-million dollar investments that they have made in building, maintaining and upgrading properties. Owners rely on brands to drive occupancy and revenue, and on managers to make the most effective and efficient use of those revenues to drive the bottom-line revenues that allow owners to cover debt service, insurance and other expenses, and provide a return – without which no thinking investor would finance a hotel.

At the same time, the Covid-19 pandemic has driven hotel occupancy and rates fallen to levels that were previously unimaginable. Brands and managers are not to blame for the pandemic, but this is the time when they must stand up and work with owners to preserve their assets and prepare for the eventual – and lengthy – return to normal, whatever that normal may be.

Unfortunately, in many cases, brands and managers have not always met the challenge. Many brands and managers have simply submitted, without explanations, edicts regarding closing or reducing operations, demanding funds, and reduced responsiveness. Hotel companies have, across the board, furloughed or laid off large portions of their workforce, making it difficult to obtain the guidance and support owners need.

What Should Owners Do?

Take the First Step. Owners cannot and should not wait for their brands and managers to provide solutions. Under current circumstances, owners maybe more aware of the status of their projects, their strengths and weaknesses, than their managers and brands. Owners should take a hard look at their properties and determine what the best course of action may be, whether it is eliminating some operations (in many areas, that decision will be made by local or statewide authorities), reduce staff, or even close (understanding that closing hotel, and maintaining a closed hotel, is an expensive proposition).

Be the Squeaky Wheel. Rather than wait for management to deliver a working capital request, require updated projections of cash flows and cash needs, and use those as a tool to make appropriate changes in operations. Many, if not most, management agreements require an owner to provide working capital funds on 10 days’ notice (in some cases less); those demands may be impossible for an owner to meet, putting the owner in default and giving managers and brands

additional leverage.

**Read Your Agreements.** Much has been made of the effectiveness, or lack thereof, of force majeure clauses. But that is not the only provision that will impact a manager’s or brand’s obligations and an owner’s rights. A thorough review of a franchise or management agreement is necessary to create a game plan. The devil may be in the details, but so are opportunities and alternatives.

**Create a Game Plan.** Now is the time to consider whether changes need to be made in the owner-manager-brand relationship. That might consist of changes to fees (not just management or royalty fees, but to marketing and other ancillary costs), operating standards and property improvement plans, but also a re-evaluation of whether the brand is the right brand or the manager is the right manager. Some brand-managed properties would benefit from third-party management, and in some cases, the brand was a bad fit from the beginning, and the pandemic has exposed greater fault lines.

**Create Allies.** Whatever decisions an owner may make, it cannot implement them with cooperation from all if its stakeholders, including lenders, investors, vendors, governmental authorities, and workers. An owner that creates a united front with all of the parties that depend on the survival and ultimate success of the property will have a better chance to achieve that success and come out of this crisis strong, and ready to take advantage of a recovery.

**Be Bold.** Sir Winston Churchill is credited with first saying, “Never let a good crisis go to waste.” This is a crisis like no other, and owners should not be timid in considering how they can better their position. However difficult these times are, we should remember that they will ultimately become a memory, not a reality, and we should prepare for the reality that follows.

The Global Hospitality Group of Jeffer Mangels Butler & Mitchell LLP works with owners and others in the hospitality industry during this crisis to create effective and meaningful solutions to intractable problems.

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Bob Braun is a Senior Member of JMBM’s Global Hospitality Group® and is Co-Chair of the Firm’s Cybersecurity & Privacy Group. Bob has more than 20 years experience in representing hotel owners and developers in their contracts, relationships and disputes with hotel managers, licensors, franchisors and brands, and has negotiated hundreds of hotel management and franchise agreements. His practice includes experience with virtually every significant hotel brand and manager. Bob also advises clients on condo hotel securities issues and many transactional matters, including entity formation, financing, and joint ventures, and works with companies on their data technology, privacy and security matters. These include software licensing, cloud computing, e-commerce, data processing and outsourcing agreements for the hospitality industry.

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This is Jim Butler, author of www.HotelLawBlog.com and founding partner of JMBM and JMBM’s Global Hospitality Group®. We provide business and legal advice to hotel owners, developers, independent operators and investors. This advice covers critical hotel issues such as hotel purchase, sale, development, financing, franchise, management, ADA, and IP matters. We also have compelling experience in hotel litigation, union avoidance and union negotiations, and cybersecurity & data privacy.

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