

HOSPITALITY LAW

Expert Analysis

Exploring the Tensions Between Hotel Owners and Brands

You've booked a stay at a hotel, finally arrived at your destination and proceed to check into your room. You immediately notice that the room appears recently updated and remarkably similar in quality, layout and décor to the room at the hotel of the same brand you stayed at a month ago in a different city. You think to yourself, how does the hotel brand ensure consistency across its various locations? Do all rooms receive frequent renovations or did the front desk associate just give me the nicest and newest room available? The answer to this question is far from simple, and lies within what are often called "brand standards" (also known as "system standards"), a supposedly uniform set of guidelines with which hotel brands require hotel owners to comply in connection with the



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build-out, operation, renovation and upkeep of hotels of a particular brand.

This article explores the tensions that arise between owners, who are usually responsible for solely bearing renovation expenses and thus prefer to upgrade their hotels based on actual hotel conditions and financial considerations, and brands, eager for renovations to occur frequently to implement the brand's latest initiative, often regardless of hotel-specific needs. Moreover, since hotel brands earn fees based on top line revenues, costly upgrades paid for by owners benefit the brands' bottom line. But, for owners, the projected return on investment often does not justify renovation costs, especially if the

hotel is already performing well. The article focuses on physical brand standards (i.e., the renovations and updates brands periodically direct owners to make) and the rights of brands to demand such renovations and of owners

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to push back on the renovation demands without running afoul of their contractual obligations to the brands.

Brand Standards, Explained

Brand standards are the standards generally prevailing across all or substantially all hotels in a brand's system of hotels. Pursuant to brand standards, a hotel must

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be operated in the same manner and to the same degree of quality as others of the same brand. Brand standards generally include “operational standards” (including services offered to guests, quality of food and beverage services at the hotel, and cleanliness), “physical standards” (including quality of improvements to the hotel, and the frequency and quality of furniture, fixtures and equipment replacements), and “technology standards” (such as the software and hardware used at the hotel, telecommunications systems, high speed Internet access, and information technology). According to brands, brand standards are designed to protect the goodwill and image of the brand and to ensure consistency across hotels of the same brand, such that consumers know what to expect when booking a stay with certain hotel brand, regardless of location.

Brand standards may also dictate when and how owners should update the asset. As with other physical assets, with the passage of time hotels undergo wear and tear, eventually requiring upgrades and renovations. But the determination of when those upgrades must be undertaken is a point of conflict between owners and brands. The cost of comprehensive renovations is steep and hotel owners bear that cost. While one might think it would be the owner’s decision of when

(and to what extent) to perform renovations, in carefully crafted hotel management agreements between hotel brands and owners, and in comprehensive brand standard manuals, brands attempt to reserve to themselves the exclusive power to dictate when improvements and renovations must be made, regardless of the financial considerations of owners, or the hotel’s precise needs. Often, the passage of time alone underlies a brand’s demand for renovations, even in the face of a hotel remaining in good condition and performing at or above the level of its competitors.

Tensions Between Hotel Owners and Brands

Hotel management agreements between owners and brands generally require that the brand operate the hotel with the goal of maximizing the profitability of the hotel. Brands are given wide discretion in determining how to operate the hotel to achieve that goal, and generally exercise full discretion and control over operations save for specific owner-controlled carve-outs. As part of such agreements, brands also are generally imbued with authority to determine what must be done to keep the hotel updated, attractive and in compliance with brand standards, and those brand standards are usually set out in detail in comprehensive

brand standards manuals. But hotel management agreements and brand standards manuals rarely specify exactly when improvements to a hotel must be undertaken, because both owners and brands (for very different reasons) desire some latitude in determining when such upgrades are to be undertaken.

Issues arise because the motivations of owners and brands conflict. Since hotel brands earn management fees based on top line revenues, costly upgrades paid for by owners benefit the brands’ bottom line. But, for owners, such upgrades require large capital outlay, and the projected return on investment often does not justify renovation costs, especially if the hotel is already performing well. This can be a source of great tension between brands and owners, who, while often joined together for decades-long relationships, have incentives that are glaringly misaligned. Brands would be content to have owners expend millions each year to keep hotels looking pristine, bolstering the brand’s profile and the hotel’s top-line revenues. Owners would rather reserve renovations for occasions when a hotel truly needs them, and to defer major capital expenditures for as long as possible so long as the hotel is performing well and is profitable.

Thus, if and when owners refuse to comply with brand demands to

perform renovations and updates, they run the risk of being served with a notice of non-compliance with brand standards, and, potentially, a notice of default under the hotel management agreement. However, since management agreements are lucrative, long-term deals which guarantee the brand significant management fees each year, termination is an unlikely outcome, especially because proving damages resulting from such termination may be difficult. Thus, what owners often face are claims by the brand that the owner is in breach of the management agreement, excusing certain of the brand's performance thereunder. And, should the hotel begin to decline in performance for reasons wholly unrelated to physical hotel conditions, brands will nonetheless point to the owner's non-compliance with brand standards as the culprit to deflect responsibility for the hotel's underperformance. Thus, owners who decide to forgo work demanded by brands must be prepared for a protracted dispute.

Advice to Owners

Brands have internal metrics by which they measure hotel performance across hotels in their system. While a hotel may be meeting or exceeding comparable hotels in performance, brands may still demand costly improvements.

Owners should be prepared to use the brand's own metrics, if needed, as a defense to demanded upgrades. Furthermore, owners should be aware, at the outset of the branding of the hotel, what the brand's expectations are concerning renovations, and if the brand has a concrete schedule for renovations, either in the management agreement or the brand standards manual. While the details of the management agreement are being finalized, owners might consider

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seeking an exhibit or addendum setting out a timeline for updates, or, perhaps, guaranteeing that renovation work need not be performed for a certain amount of years subsequent to opening. Establishing such certainty will allow owners to better budget for future work at the hotel, while enjoying economic certainty in the near term.

Conclusion

The tension between owners and brands concerning timing and frequency of hotel renovations to

maintain compliance with brand standards is significant. While compliance with brand standards is mandatory under hotel management agreements, what constitutes compliance is a grey area and when and to what extent brands can demand major capital work be performed is an unsettled question. It is critical for owners to fully understand not only the contractual requirements of management agreements but also the limitations on leverage actually held by the brands. Maintaining a positive relationship with the brand is a key to a successful long-term relationship under management agreements that can last upwards of 50 years, and owners need to know when to capitulate to brand demands and when to stand firm against unreasonable demands, which, while allegedly required to maintain brand standards, may actually be designed to simply drive top-line revenues at a hotel (but not profitability) and benefit brands at the cost of owners.