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Managing the Key Issues Affecting Hospitality M&A Deals

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The first half of 2018 has seen corporate mergers and acquisitions reach all-time highs in the United States and globally, a culmination of a strong M&A trend—exceeding $3 trillion—which has been building since 2015. With significant cash on hand as a result of rising profits in the robust post-recession economy and favorable changes to the federal tax code, many companies are opting to accelerate their growth by purchasing other companies to acquire technology, intellectual property, assets, talent, customers and/or market share.

M&A transactions in the hospitality industry have mirrored the overall uptick in M&A activity over the last three years, with significant consolidation including the $13.3 billion acquisition by Marriott International of Starwood Hotels & Resorts Worldwide in 2016; the $1.95 billion acquisition by Wyndham Hotels & Resorts of La Quinta Holdings earlier this year; the recently closed $318 million acquisition by AccorHotels of a 50 percent equity stake in sbe Entertainment Group; and the recent public announcement by Hyatt Hotels Corp. of its intention to acquire Two Roads Hospitality for $480 million. In addition to general economic factors fueling this trend, the hospitality industry has confronted, and continues to confront, industry-specific influences that are compelling companies to seek to merge with or acquire other hospitality companies. In particular, the hospitality industry remains highly fragmented, with no single company holding significant global market share.

It must also contend with the increasing power and reach of online booking sites, and the impact of alternative lodging companies such as Airbnb. Rather than relying solely on organic growth, by acquiring other hotel brands, hospitality companies are electing to rapidly broaden their portfolios and strengthen loyalty programs, increase their leverage with respect to online booking sites, defend against alternative lodging companies, and expand into new markets.

This article explores some common issues that arise in M&A negotiations involving hospitality companies and provides guidance for how companies should address the related risks and liabilities. Fully understanding these risks and liabilities prior to entering into a M&A transaction is particularly important in light of the Delaware Chancery Court's recent decision in *Akorn Inc. v. Fresenius KABI AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018), in which the court released the buyer, Fresenius, from its obligation to close its acquisition of Akorn as the result of the occurrence of a material adverse effect (MAE)—the first instance in which a Delaware court has released a buyer from such an obligation based on the occurrence of a MAE.

Common Issues

Issues that commonly arise during M&A transactions involving hospitality companies include withdrawal liability, ownership of intellectual

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property and data breaches. Although all of these issues may not arise in every transaction, and there will of course be others, it is incumbent on parties to a potential M&A transaction to fully grasp the potential economic impact of these issues.

Withdrawal Liability. Hospitality companies that own or manage hotels, particularly in large urban areas, typically have unionized employees covered by collectively bargained agreements requiring contributions to one or more multiemployer plans. In the event of a change in manager or a sale of a hotel, the seller or the terminated manager may experience a complete or partial withdrawal from a multiemployer plan, resulting in potentially significant withdrawal liability.

Generally, for purposes of labor laws, the hotel manager is the "employer" of the unionized hotel employees. However, under ERISA, the hotel owner could be the employer (various factors impact the determination of whether the hotel owner or manager is the employer). A change in the employer could trigger a complete or partial withdrawal. Even if a hotel owner and manager agree on who is the employer of the unionized employees for ERISA purposes, a multiemployer plan may disagree and assess withdrawal liability on the party it determines is the employer. Management agreements will typically provide that between a hotel owner and manager, the hotel owner is ultimately responsible for any withdrawal liability.

To mitigate the risk of a material withdrawal liability, the parties should consider: (i) who is the employer for ERISA purposes, and (ii) who bears the liability for withdrawal liability under the management agreement. In addition, it may be prudent for companies in the hospitality industry to seek annual estimates of withdrawal liability from any multiemployer plans in which they participate in order to help them understand their withdrawal liability exposure.

Ownership of Intellectual Property. An important objective in many M&A transactions within the hospitality industry is the acquisition of additional brands for the purpose of expanding a buyer's brand portfolio. For that reason, the target company's ownership of the intellectual property relating to its brands is of utmost importance to buyers. Although third-party claims of ownership of a target company's hotel brands may be less common, hospitality companies with restaurant or other food and beverage brands should be cautious when developing new brands in partnership with chefs or other third-party partners.

> With M&A activity in the hospitality industry expected to remain high in the foreseeable future, it is important that potential sellers and buyers understand the common issues that arise in negotiating M&A transactions involving hospitality companies.

When unclearly and/or hastily documented, a valuable restaurant or other food and beverage brand in a target company's portfolio may present material issues in a M&A transaction if there is any indication that a third party has asserted, intends to assert or could assert a claim to ownership of any interest in such brand. Such claim may significantly undercut the valuation of the brand and the target company.

Before entering into a M&A transaction, target companies should take a closer look at their brand portfolios to determine whether any brands—e.g. hotel, restaurant or food and beverage, nightlife or other venue—have been developed jointly with a third party and, if so, whether the ownership and/or fee arrangements have been clearly and adequately documented between the parties.

This holds true even if a target company has operated consistently over a period of time as if it fully owns all rights to the subject intellectual property and/or if the applicable third party has made reference to an ownership claim but has not yet formally asserted such claim. The objective would be to ensure a clear (and, ideally, documented) understanding as to the target company's ownership of its brands so that a potential buyer may appropriately value the target company's brand portfolio.

Data Breaches. With technology being used at each step of the hotel booking process, from a hotel operator's mobile app permitting booking and check-in to the popularity of consumer review sites such

as TripAdvisor, potential buyers in M&A transactions must pay careful attention to the risks and liabilities surrounding a target company's data protection and cybersecurity practices, particularly as it relates to compliance with governmental regulations. Buyers should request detailed data protection and cybersecurity due diligence responses from target company management and push to include lengthy and detailed representations and warranties regarding such matters (rather than relying on a general compliance with law representation).

With the passage of new laws addressing data privacy and protection, including the European Union's implementation of the General Data Protection Regulation (GDPR) earlier this year, buyers rightly are becoming less amenable to the idea that they should bear significant risk post-closing for violations of these regulations and any claims from third parties arising from data breaches.

In order to maximize the value of a target company in a M&A transaction, management should consider performing a thorough review of its current compliance with existing data protection and cybersecurity regulations and take steps to confirm best practices are undertaken company-wide to ensure compliance and to reduce exposure to potential data breaches. This may also include obtaining an insurance policy to cover risks relating to cybersecurity and data breaches.

Implications of 'Akorn'

The Akorn decision yields important implications for sellers and buyers negotiating a potential merger or acquisition. Most significantly, companies seeking to sell an equity stake or assets would be wise not to rely on the standard MAE defined term and related carve-out concepts and should instead specifically tailor such provisions based on their historical and current business operations. This is especially important in light of the Delaware Chancery Court's finding that a buyer having known or not known of a foreseeable MAE in advance has no impact on the existence thereof.

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Specifically tailoring the MAE defined term and related carve-outs would require that selling companies undertake thorough assessments of their historical and current business operations to identify and understand more clearly potential risks and liabilities that could potentially constitute a MAE, including the common risks and liabilities discussed above arising from withdrawal liability, ownership of intellectual property, and/or data breaches. If any identified risks or liabilities are reasonably expected to occur or to continue between signing and closing, selling companies should seek to revise the MAE defined term and related carve-outs such that a MAE will not be triggered by the occurrence of such risks or liabilities. This would effectively force a buyer to acknowledge its awareness of a foreseeable MAE and agree to close over such MAE should it occur before closing.

Conclusion

With M&A activity in the hospitality industry expected to remain high in the foreseeable future, it is important that potential sellers and buyers understand the common issues that arise in negotiating M&A transactions involving hospitality companies. It would be prudent, particularly in light of the implications of *Akorn v. Fresenius*, for all parties to have a clear understanding of potential risks and liabilities of a target company that may arise or continue between signing and closing and how such risks and liabilities should be addressed by potential sellers and buyers to ensure certainty of closing.