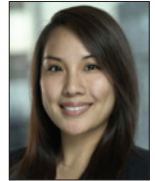


HOSPITALITY LAW

Managing Key Issues Affecting Hospitality M&A Deals: Part II



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As we discussed in Part I of this series (“Managing the Key Issues Affecting Hospitality M&A Deals,” Oct. 31, 2018), merger and acquisition activity in the hospitality industry is at an all-time high. According to *Hotel News Now*, 18 major merger and acquisition transactions in the hospitality industry were announced in 2018, closing out a record-setting year of M&A activity and extending a years-long trend of aggressive consolidation in the industry. AccorHotels alone—one of the largest hotel companies in the world—announced four major acquisitions in 2018, including the acquisitions of 21c Museum Hotels, Mövenpick Hotels & Resorts, Atton Hoteles, and a 50 percent equity stake in sbe Entertainment Group, executing on its ambitious plan to significantly increase its portfolio of hotel brands outside of Europe.

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As further evidence of the strong M&A activity in the industry, in the short period since the publication of our article in October 2018, a consortium led by Jin Jiang International Holdings—recognized as the largest hospitality company in China—announced the completion of its acquisition of Radisson Holdings, and VMH Moët Hennessy Louis Vuitton announced its intention to acquire Belmond Ltd. at an enterprise value of \$3.2 billion.

In light of the hospitality industry’s sustained high levels of M&A activity, which we expect to see continue in 2019, our October article discussed three common issues that can expose hospitality companies to significant risks and liabilities. This included the target company’s withdrawal liability with respect to its unionized employees, liabilities resulting from issues with ownership of the intellectual property relating to the target company’s brands, and liabilities arising from data breaches at a target company or its lack of protocols for safeguarding data privacy and cybersecurity.

In this article we explore additional issues commonly encountered by parties to hospitality M&A transactions and provide guidance for how parties should evaluate the related risks and liabilities.

More Common Issues

Hospitality M&A transactions often must deal with (1) change of control triggers in hospitality-related contracts such as management agreements, leases and loans, (2) rights of first refusal (or similar rights) held by joint venture partners, and (3) geographical issues—namely, restrictive covenants and fiduciary issues—stemming from an acquisition where the acquiring company and the target company may have branded venues within close proximity of each other. These particular issues may have a direct impact on the parties’ ability to close the transaction and, after closing, the parties’ ability to operate the combined business.

Change of Control Triggers. As is required in any “change of control transaction,” a buyer should

conduct a thorough review of the target company's material contracts to identify and analyze any applicable change of control provisions. For a hospitality company, material contracts generally will include management contracts, leases and loans where the consent of an owner, a landlord or a lender to a change of control in a manager's ownership structure (or the assignment of the agreement in an asset sale) is commonly required as the result of the owner's desire to control who will be managing its hotels, the landlord's desire to control who will be its tenant, or the lender's desire to control the borrower's ownership and business operations.

The failure to obtain any required owner, landlord or lender consent may subject the target company to potential liability for breach of contract and, in more severe circumstances, may trigger an owner's or landlord's right to terminate the contract or a lender's right to declare an event of default and accelerate payment of the loan, in each case, resulting in financial loss to the target company. Certain leases or loans may also permit a landlord or lender to require additional payments based on the change of control transaction, which amount could be substantial, or require the buyer to undergo extensive review by the landlord or lender to confirm its financial standing, which could delay the closing of a transaction.

In some circumstances, complying with a required change of control provision where the owner, landlord

or lender has a difficult relationship with the target company may allow the owner, landlord or lender to exercise significant leverage in renegotiating the underlying contract, effectively holding the closing hostage to secure more favorable terms.

The parties should work closely to identify all such consent requirements and, once identified, the seller should be candid about the feasibility of obtaining any such consents from both a timing and a business vantage point. If any consents are determined by the parties not to be required at closing, particularly if the underlying agreement represents a material portion of the

Understanding the effect of these provisions in the M&A context will be valuable throughout the day-to-day operations of a company's business, particularly as opportunities for the company to enter into management agreements, leases, joint ventures or other contracts present themselves.

target company's business, the buyer should consider requesting a special indemnity to ensure it is compensated for any loss in value to the target company's business resulting from the failure to obtain such required consents.

Joint Venture Partners' Rights of First Refusal. Joint ventures are not uncommon in the hospitality industry as companies seek to combine their respective resources to jointly undertake projects that

typically require significant capital investment. It does not come as a surprise then that many joint venture partners want to ensure they are entering into that business relationship with their intended partner and negotiate rights to buy out their partner's equity interest in the event such partner enters into a merger or acquisition transaction.

Whether a joint venture partner with a right of first refusal (or similar right) will decide to exercise that right may be out of the buyer's or seller's hands; however, the parties should nonetheless understand how such a decision by the joint venture partner will impact the transaction. If the joint venture partner chooses not to exercise its right because it is comfortable with the transaction and, more importantly, the buyer's control of the target company post-closing, then a buyer may want to require for the sake of certainty that such waiver be in writing. If the joint venture partner chooses to exercise its right, then buyer should understand the economic impact of that joint venture no longer being owned by the target company and consider an adjustment to the purchase price.

If a joint venture represents a material component of the target company's business, buyer may want to consider requiring a waiver of the exercise of such right of first refusal (or similar right) as a closing condition to the transaction itself such that the buyer would have no obligation to close the transaction if the joint venture partner exercises its right.

Restrictive Covenants and Fiduciary Concerns. A buyer with venues in close proximity to a target company's venues may raise issues relating to compliance with any restrictive covenants binding the buyer's or the target company's venues or business and related fiduciary issues.

Both a buyer and a target company with venues operating in a certain geographical area may be subject to restrictive covenants prohibiting it from owning, managing or operating competing businesses within a certain radius of the subject venue. These restrictions are often negotiated by owners party to a management agreement or landlords party to a lease to ensure that the buyer or target company does not have competing venues within a certain radius restriction that could have an adverse economic impact on the subject venue's business.

To ensure both parties are adequately analyzing the impact of such provisions, the parties should identify any such provisions in their respective material contracts and carefully evaluate whether the consolidated business post-transaction may be deemed a violation thereof. If a potential violation is identified, then the buyer may want to consider requiring a waiver of such violation as a closing condition to the transaction.

Beyond compliance issues with relevant restrictive covenants, the buyer should also consider carefully its intended operations after consummation of the transaction.

The buyer and the target company may have various corporate or other business relationships that would require it to direct business opportunities to certain venues over others.

The acquisition of competing venues within a shared geographical area may present new issues for the buyer as to how to fairly allocate business opportunities to such venues. Failure to have the appropriate policies in place may be interpreted as the buyer favoring one venue

Any of the foregoing issues identified in a buyer's due diligence review should be considered carefully in light of their potential impact on the transaction and the operational concerns a buyer may need to grapple with after consummation of the transaction.

to the detriment of another venue and potentially expose the buyer to liability for violations of its fiduciary obligations.

Conclusion

This two-part series has identified some of the most pertinent issues arising in hospitality M&A transactions, including withdrawal liability, intellectual property ownership, data privacy and cybersecurity exposure, change of control triggers, joint venture partners' rights of first refusal, and non-competition restrictions and fiduciary obligations in the context of competing

venues within a shared geographical area. Any of the foregoing issues identified in a buyer's due diligence review should be considered carefully in light of their potential impact on the transaction and the operational concerns a buyer may need to grapple with after consummation of the transaction.

Furthermore, understanding the effect of these provisions in the M&A context will be valuable throughout the day-to-day operations of a company's business, particularly as opportunities for the company to enter into management agreements, leases, joint ventures or other contracts present themselves. Rather than considering the provisions related to the foregoing issues solely from the standpoint of how such provisions will immediately impact company operations, management may want to take into account how such provisions may impact the future value of a sale of the company in the long-term and consider negotiating these provisions more aggressively with the objective of maximizing its value in a future sale transaction.