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Newsletter

March 2024

Australia: White label hotel managers – To what extent do they differ from the legacy managers?

Introduction

In November 1968 the Beatles released their ninth studio album. The album featured a plain white sleeve, the cover contains no graphics or text other than the band's name embossed on it. The album is generally referred to as the White Album and is considered to be one of the greatest albums ever released.

In time white label hotel management may seek to aspire to such an accolade. White label management is so called because the day to day operational activities of such managers are usually invisible to the public. White label managers are the new kids on the block in Asia Pacific including Australia but are well established in other parts of the world and particularly the United States and command a very impressive market following.

While label managers usually undertake their duties in concert with a franchisor which makes available to the hotel owner a well recognised brand, centralised services such as reservations and the availability of cutting edge technical support on an as needed basis. The club of white label managers in the Australian market is small but growing (think the likes of LaVie, 1834 Hotels, Trilogy, Gatehouse Hospitality, Lancemore and potentially Salter Bros). By comparison the "legacy managers" (think the likes of Accor, Hilton, Hyatt IHG, Mandarin Oriental, Marriott, Shangri- La together with the local operators such as TFE Hotels), bundle the management services offered by white label managers with all the abovementioned services provided by franchisors. In fact the legacy managers in another guise are generally the franchisors who work in conjunction with the white label managers who should not be confused with the "soft" brands used by the legacy managers (think MGallery by Accor, Autograph by Marriott and Curio by Hilton) which is a form of public facing branding used by these managers.

For the white label managers to successfully compete against the legacy managers, who after all have a well-entrenched, if not commanding, position in most markets around the world, there is a need, in our view, to identify points of difference with the approach to the major commercial terms which underpin hotel management agreements and fashion an arguably more owner friendly offering. In this newsletter we have reached out to white label managers and other industry experts as to what white label managers are prepared to agree to both in the Australian market and in the US. We thank them for their contributions to this newsletter.

In this issue

Interestingly, there appears to be a realisation in the US that for hotels under 1000 rooms the white label operators are the operators of choice, perhaps because they are better suited to provide individual focus to smaller properties. For these smaller properties the legacy managers tend to focus on franchising which we are advised can be very lucrative. The exception would seem to be in the luxury space where the legacy managers, for totally understandable reasons, are only prepared to provide access to their most prestigious brands irrespective of the room count under a management model rather than a franchise model.

We will now seek to determine whether there are any meaningful distinctions to the largely universal approach adopted by the legacy hotel managers. The commercial positions set out below which are based on our exposure to hundreds of management agreements in Australia and elsewhere are in each case a "sense of the meeting" approximation – of course during any particular negotiation an individual manager may make concessions beneficial to the owner in an attempt to secure a sought after management opportunity.

Self-evidently, attractive commercial terms are only part of a compelling value offering. An impressive track record of effective service delivery, a skillful ability to control costs and a steely eyed focus on maximising profit are potentially as important if not more important than attractive commercial terms. Most of the major legacy operators have been in business a long time, have demonstrated that they can perform impressively in a variety of jurisdictions and have grown to become multibillion dollar corporations off the back of a business model which has served them and their guests well over an extended period.

As usual, the views expressed in this newsletter are those of the author alone. As with all our newsletters, we trust you find what follows informative and thought provoking. Any feedback would be appreciated.

Term

The Legacy Operator Club	The Australian White Label Operator Club	The US Perspective
Minimum term of **ten (10) to fifteen (15) years** (and can be as long as eighty (80) years).	Minimum term of **five (5) years**. This needs to be considered in conjunction with our comments below in relation to termination at will. If there is a Franchise Agreement, minimum term is **ten (10) years.**	Usually **ten (10) years** with termination at will typically available after **three (3) to five (5) years.**

Base Management Fees

Minimum amount of **1%** of (Adjusted) Gross Revenue (and ranges up to **3%** or higher)	Nil or very low with an emphasis on the Incentive Management Fee. Franchise fees may also be applicable - typically **2% to 4%** of Gross Rooms Revenue	Usually, **2%** percent of Gross Revenue but typically capped as a percentage of Net Operating Income (usually **3% to 3.5%)**

Performance Termination

A combination of Actual v/s Budget & RevPAR Comparison (less frequently a limb of the test relates to Gross Operating Profit as a % of Gross Revenue) Actual v/s Budget:- • Minimum period available is two (2) consecutive years (sometimes three (3) consecutive years) • Commences no earlier than fourth (4th) Full Operating Year • Triggered if actual profit is less than around 80% of budget • Force Majeure events cancel out affected Operating Year (and the prior Operating Year if triggered as well) • Cure – minimum two (2) cure rights • Cure payment - top up for one (1) trigger year at Operator's discretion. • Cure repayable in certain circumstances. Rev PAR Comparison.	Various approaches:- • Not offered if there is a termination at will provision which can be accessed relatively early in the life of the HMA; • Only offered if pressed and only Actual v/s Budget; or • Same	Usually terminable without cost if performance thresholds are not met as a measure of return on invested capital. Also termination at will usually available after **three (3) to five (5) years** for no fee.

• A minimum number of competing hotels - around four (4) - in Comp Set • If hotels available to be included in Comp Set falls below minimum number then Performance Test does not apply for relevant years. GOP as a % of GR • Percentage agreed at time of execution of HMA including new builds		

Financier Restrictions and Non-Disturbance Agreements

Financial restrictions • Owner only permitted to borrow from financier approved by operator. • Owner must show operator all finance documents. • Loan to Value ratio cannot exceed a specified percentage (usually around 60%) • Interest payments cannot exceed a specified percentage of Gross Revenue. • The financier cannot be a competitor of the operator or affiliated with a competitor. Non disturbance Agreements • Financier must execute an NDA in a form approved by the Operator	Various approaches:- • No financial restrictions; • Other than approval not being required, generally the same.	No restrictions.

Dispute Resolution

A mix of Binding Expert Determination and Arbitration – specified provisions dealt with BED and the remainder by Arbitration. Binding Expert Determination • If parties cannot agree on identity of Expert then usually determined by a third party (e.g. Court of Arbitration of the International Chamber of Commerce in Australia) Arbitration • Usually a recognised seat of arbitration (e.g. Singapore International Arbitration Centre) • Place of arbitration normally a jurisdiction that neither the owner or operator has a presence.	Various approaches:- • Expert only • Generally same.	Usually arbitration but significantly less important if termination at will is readily available.

Budgets - Pre-Opening and Annual

• Operators will not agree to be restricted to Operating Expense numbers in the budget.	Various approaches:- • Capped • Generally same.	Generally same.

• No cap
• Regarding annual budgets, specified line items not subject to owner approval rights including:-
  • Brand Standard requirements;
  • Fire, health or safety/security standards;
  • Fees;
  • Legal requirements; and
  • Employee conditions of employment
• Projections non-binding		

Construction Milestones

• Owner breach of milestones an event of default entitling operator to claim for damages and terminate. • If operator does not exercise termination right then agreement binds owner indefinitely and prevents owner from using the land for any purpose other than a hotel.	Various approaches ranging from no milestones to generally same.	No milestones.

Assignment restrictions

Several restrictions imposed on owner including prohibition on sale to operator competitor.	Various approaches between no restrictions and same restrictions. Franchisor may impose restrictions.	Usually, the management agreement cannot be assigned.

Area of Restriction

• Limited to same brand as applies to hotel
• May exist for a period of lesser duration than the Term
• Exclusions may include:-
  • Hotels acquired by operator and located within AoR
  • Hotels forming part of a casino complex
	Various approaches between no restrictions and same restrictions
	Franchisor may agree to restrictions.
		No restrictions

FF&E Reserve

Cash based rather than notional	Various approaches encompassing:- • no need for such a fund • notional • cash	Cash based

Brand Standards

• Hotel must be constructed in a manner consistent with the Brand Standards and must always comply with any variations to the Brand Standards – including variations which come into being immediately after the hotel's opening date. • Brand Standards are never disclosed to owner until the HMA is executed and can vary significantly in terms of detail and guidance to the owner	Generally franchisor issue if applicable – except for fire and life safety.	Generally a franchisor issue. In some instances an obligation that hotel is operated in a manner consistent with hotels that it competes with (e.g a comp set for properties in historic areas or beach areas where some of the other hotels in the comp set are located hundreds of miles/kilometers away)

Termination on sale

• Strongly resisted but agreed to on rare occasions • Commences after opening date (usually around the seventh (7th) full operating year) • Must be a truly arms-length sale • A Termination Fee is payable which can equate to the fee stream over the remainder of the Term	Various approaches:- • The principle of termination on sale is a given. Only material difference between these white label operators relates to when in the Term the right arises. • Generally same	Always available. Typically without a fee payable after 3 to 5 years

Without cause termination

• (Almost) never available	Various approaches from always available to never available.	Always available after 3 – 5 years typically without a fee

Employment of employees

• Almost all hotel employees must be employed by owner under the exclusive day to day control of the operator • All employee costs to the owner's account; • All employment terms determined by operator except for Key Personnel; • All terminations and redundancies determined by operator.	Various approaches:- • Open to employing the employees (subject to appropriate indemnities and financial capacity) • Generally same.	Generally same.

Taxes including Gross ups

• All withholding taxes on operator fees borne by owner (other than base and incentive fees) • Any taxes imposed upon centralised services payable by owner.	Generally same except that usually there are no centralized services (which would usually be provided by a Franchisor)	Generally same

Guest Data

All guest data the exclusive property of the operator	Various approaches:- • Owner's property (except for enhanced data) • Guest data generally owned jointly by owner and operator.	General consensus not to own guest data unless it is necessary. This is a departure from the prior paradigm where guest data was jointly owned.

Performance Guarantees

• Only provided as a consequence of negotiation • Usually refundable	Not usually provided for reasons including:- • Presence of readily available termination at will provision. Fees are principally dependent on operating fees however stand asides may be considered if appropriate	Not offered.

Rights of first refusal

• If the owner wishes to sell the hotel either as a consequence of an unsolicited offer or through a public sale campaign then it must first offer the hotel to the operator and there are adverse consequences if the owner rejects the operator's offer and the event sale price offered by a third party buyer is less that the operator's price. • If the hotel is destroyed and a new hotel is constructed within a period thereafter (around three (3) years) then owner must offer management to the operator on same terms as original HMA.	Not a relevant operator consideration.	Not an operator consideration

Centralised Service Charges including marketing activities

• No scope for owner to negotiate centralised services charges (such as reservations, group training, guest surveys etc). • Owner has no ability to influence centralised marketing activities. • No explanation provided as to how individual charges are calculated. • No capacity for an owner to audit such charges.	Various views encompassing:- • No difference except that charges minimal; • Charges are transparent; • Services including marketing (which are usually optional) and relevant charges provided by franchisor.	Charges are part of a broader cost discussion and are generally minimal basically relating to reservation fees.

Disclosure of HMA templates as part of Operator selection process

Most operators are not prepared to submit HMA templates for review as part of operator selection.	Various approaches. Some will provide some will not.	Various approaches.

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Conclusion

As the above table indicates, in certain respects the legacy managers and the white label managers are marching to the same tune. In other respects, there are significant differences not only as between legacy managers and white label managers but as between white label managers themselves.

Perhaps the most conspicuous differences relate to:-

- term – white label managers would appear to be open to shorter terms than legacy managers; and
- premature termination – white label managers appear more disposed to accept the concept of termination at will and/or termination on sale.

The approach taken by the white label managers is arguably more owner friendly as it gives an owner the flexibility to termin ate the manager's services at an earlier point in time if the owner is either dissatisfied with the manager's performance or simply wants the freedom to assume day to day management of the hotel.

The US information suggests that the white label managers in Australia are on a journey which has some way to go.

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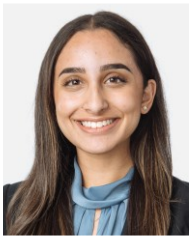

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