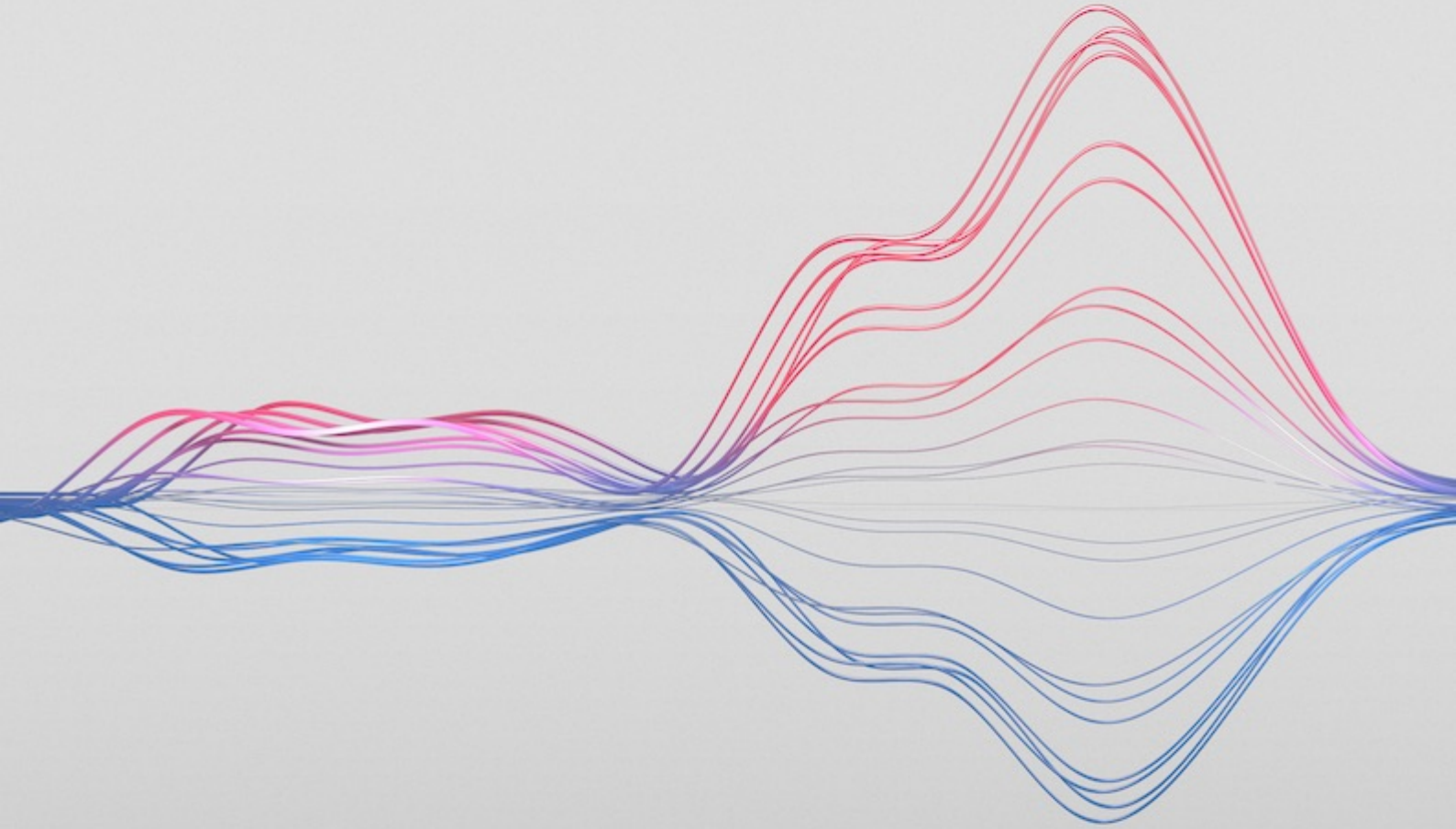
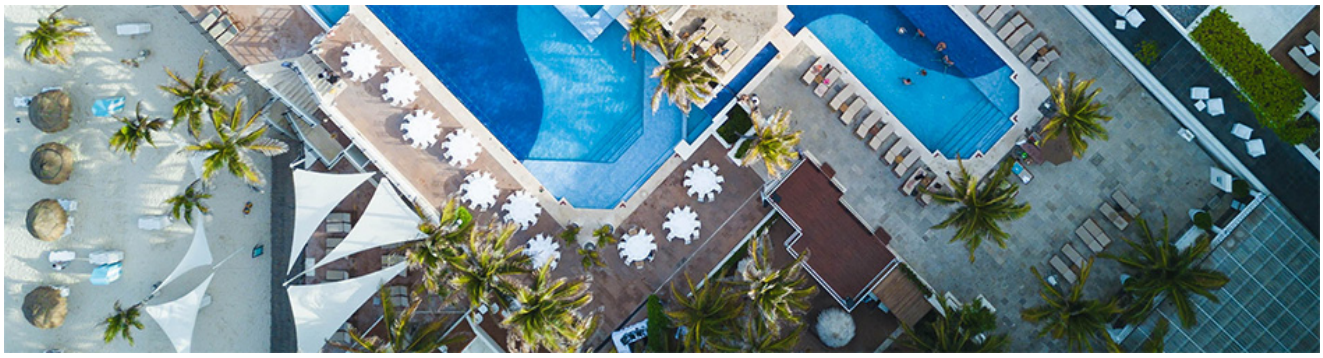
AUSTRIA

Hotel Management Agreements



Introduction



One cannot discuss the evolution of hotel management agreements (HMAs) without first talking about the separation of hotel ownership and hotel operations; a transformation of the major chains' business models, more commonly known as an "asset light" strategy. Today the form taken by hotel operators in HMAs is an important factor in the effective working of the market in hotel investment. DLA Piper's Hospitality and Leisure Sector Group has negotiated HMAs for a myriad of different clients across the H&L landscape (owners, investors, operators (both branded and white label) and lenders) in all of the world's key jurisdictions.

Many consider hotel management agreements to be borne out of a modified lease for the Hong Kong Hilton back in 1963, and the main terms included in it underpin most HMAs to this day. All major chains today have, to one degree or another, expanded nationally and internationally through a combination of franchise and management, and all have their own "form" or template agreements. In summary, over the last few years, we have found that trends that started as a result of the financial crisis of the last decade have continued to develop. In many markets the advent of recession made operators more risk averse. Traditionally HMAs were a means to limit operators' exposure to fixed rental payments when revenues were dropping. In less developed markets, even with a degree of economic recovery, operators have continued to use HMAs in this way. In more developed markets, such as Spain and the United Kingdom, we have seen increased complexity in agreements, a symptom of owners becoming more knowledgeable and seeking more control and input on the operation of their hotel, although owners continue to take the lion's share of commercial risk in developments.

Another important factor, as with any real estate investment, is the attitude of those who are providing the money, be it equity or debt. Leases were the traditional mainstay of hotel developments and indeed Germany remains a country where hotel deals are commonly based around leases. However, as investors have started to see the increased returns from ownership, the boom in arrangements like ground leases and other market changes is essential to have an understanding of investors and be able to work with them in a scenario of increasingly complex legal arrangements.

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Austria

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General

Are Hotel Management Agreements (HMAs) common in the jurisdiction?

Yes, the conclusion of HMAs is on the rise in Vienna, Austria, especially regarding city center mid to upper tier hotels under a brand to drive expansion of those brands forward. However, the risk is minimized by taking in investors.

If not HMAs, what are the alternatives / what is commonly used?

- For the purpose of expanding their own brand, well-known hotel companies often provide franchisees (white label operators) with their trademark rights, a tested procurement, marketing and sales structure as well as support regarding education and training of employees. The significant surge in brand franchise has also seen an increase in operating franchised hotels – without having their own brand.
- Lease agreements as traditional investments are also common in the Austrian hotel sector.
- License agreements, where the licensee assumes only certain trademarks (eg names, logos) from the licensor (in contrast to franchise agreements) or cooperation agreements with marketing companies, are less frequent on the Austrian market.
- Purchase agreements are quite uncommon because of the obvious financial risk.

Is it common or usual for the HMA to be governed by (i) local laws; (ii) the laws of one of the parties' country of incorporation; or (iii) an alternative jurisdiction?

HMAs in Austria will, in general, be governed by Austrian law as *lex situs* (law of the place where the hotel is situated) or by German or English law. It could be linked to the conclusion of an arbitration clause (eg VIAC or ICC with the seat of arbitration in Vienna).

Are there any significant or unusual points to note in respect of tax on HMA payments in the jurisdiction?

In general, both owners and operators have to be aware of VAT and withholding issues on payments (with regard to third country nationals or firms).

As under US GAAP and IFRS, contingent liabilities have to be shown in the balance sheet, CAP regulations (limiting the liability of the owner /investor regarding the losses of the operator to a fixed amount of maximum two-year leases) are inserted into HMAs. The reason is that an increase of contingent liabilities in the balance sheet would lead to a deterioration of the rating and thus increase refinancing costs of the company.

Term and termination

Is there a standard contract period of an HMA?

Normally, the contract period for lease and management agreements is limited to 15–25 years with one or two extension option(s) for five years each.

Is the term usually fixed? Are early exit or similar options included (contractual or implied)?

Yes, normally agreements are concluded for a definite period.

Is it usual to include fees / liquidated damages for early termination?

Exit fees for early termination, other than due to operator default, are common. The level of fees can vary widely depending on a number of issues (eg location, brand, scale): eg 50% of the average turnover for the last three years.

What is the usual position in respect of renewal?

Normally included to provide more flexibility (see above).

Fees

Is there a standard fee structure for HMAs (eg base + incentive)?

The operator receives:

- a base fee: typically 2-4% of the aggregate turnover; and
- an incentive fee: performance-based compensation: often 8-10% of the gross operating profit (GOP) or the GOP less the base fee (Adjusted GOP or AGOP).

Those fees are usually indexed (eg consumer price index).

What other fees and charges are there (such as royalties, accounting, marketing, license fees, etc.)?

In addition, the operator receives the following from the owner of the premises/investor:

- a pre-opening grant for the sales and marketing activities of the operator one to two years before the opening (Soft-opening);
- technical services fees: fee for the provision of services and contribution of know-how in the planning and construction process;
- marketing fees;
- reservation fees;
- internet/website fees;
- IT installation fees;
- bookkeeping, accounting and controlling fees;
- quality assurance fees (including quality control);
- charges for loyalty programs;
- human resources and training fees;
- working capital: basic financial equipment of a hotel to ensure liquidity; and
- IT services fees: provision of EDP software and hardware and for computer training.

Are owners typically required to set aside funds for fixtures and fittings?

An FF&E Reserve (reserve for furnishings, fixtures and equipment; 1-5% of the turnover), a maintenance reserve for the replacement of such articles, is very common in Austria. Part of the FF&E Reserve is the OS&E Reserve (reserve for operating supplies and equipment: eg glasses, cutlery and dishes). Replacements are credited via the operating budget as direct costs. The holder of the reserve is the owner in

case of HMAs and the operator in lease agreements. However, the obligation is often shared to motivate the operator to give the operator the incentive to treat the assets with care and to use the funds sparingly.

Performance and operations

What is the usual standard imposed on an operator in respect of the operation of the hotel?

Yes, again international standards are customary. The incentive fee is often linked to a stand-aside clause. The incentive fee is paid to the operator in case the investor has previously received a specified minimum or fixed amount.

What performance measures are commonly used in the jurisdiction?

A performance test is fairly standard, but the type and nature can vary depending on the operator, nature of the hotel, location, etc.

Is an operator or owner guarantee common in the jurisdiction?

Yes, the operator guarantees a certain operating profit either in the form of a group surety, letter of commitment or bank guarantee. This is to ensure that the owner/investor receives a certain compensation even if the operation profit is not reached.

What is the usual position in respect of employees? With whom does the liability for the employees sit?

This largely depends on the arrangement of the applicable employment agreement and the allocation of responsibilities. However, in many cases the employment will remain with the owner. The appointment of key positions requires approval of the owner (budgeting, sublease and replacement investments as well).

Is it usual to have a non-compete clause, eg that no other property with that brand can open within a certain radius?

Yes, mostly for the duration of the contract. The radius is bigger for luxury hotels.

Who is responsible for insurance?

In general, the employer is responsible for the insurance of the employee. However, if a person different from the employer predominantly bears the economic risk (regarding administration, household and activity) and receives the profit obtained, such person and the employer are jointly liable for social security contributions.

Does the HMA give rights in real estate in the jurisdiction?

Not in itself. But it is possible to make a note in the land registry system to reveal personal circumstances of the owner with the legal consequence that whoever obtains registration in the relevant land register deposit cannot rely on the ignorance of such circumstances. Such provision explicitly names the following circumstances: restrictions on asset management, for example, the note of minority; the appointment of a trustee; the attainment of majority; and the opening of insolvency proceedings. However, in practice, this is not done often.

Does the HMA need to be recorded against the property, if this is possible in the jurisdiction?

It is not necessary to register the HMA, but might be implemented in favor of the operator (please see Rights in real estate).

Where financing is taken, is it standard to obtain a Non-Disturbance Agreement (NDA) as part of a management or lease agreement?

NDAs are included in HMAs if the operator intends to take up a loan regarding activities of the hotel. However, they are not a decisive factor during the negotiation of HMAs in comparison to fees, performance clauses and termination rights.

What other agreements usually sit alongside an HMA in the jurisdiction?

Sometimes, a tri-partite agreement is concluded between the owner, the operator and the financing banks.

Transfers and assignments

What are the standard rights / restrictions in respect of transfer / sale of the hotel?

Transfer rights under HMAs can vary widely. Commonly, operators will require consent to any change in ownership of the hotel or at least require restrictions on transfers to competitors.

When a managed hotel is sold (either asset or share deal), is it usual in the jurisdiction that either the Operator's consent is required for the sale, or that the hotel may only be sold if the HMA transfers with the hotel?

The owner and the operator may agree on the requirement of the transfer of the HMA by way of an assumption of contract *(Vertragsübernahme)*, especially if an NDA is contained in the HMA and finance is involved.

Do HMAs commonly include a right of first refusal for the operator to purchase the hotel?

Previously, this was more common. The Austrian Federal Tax Court (BFG) rendered a decision regarding the lease agreement dated May 30, 2007, with respect to a hotel where the operator was granted a right of first refusal.

Is it usual to include provisions which enable the sale of the property with vacant possession ie without the brand?

Owners and operators usually agree on the restriction of transfers to competitors, and a sale without the brand seems quite unlikely. If it is ever given, there is usually an exit fee.

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