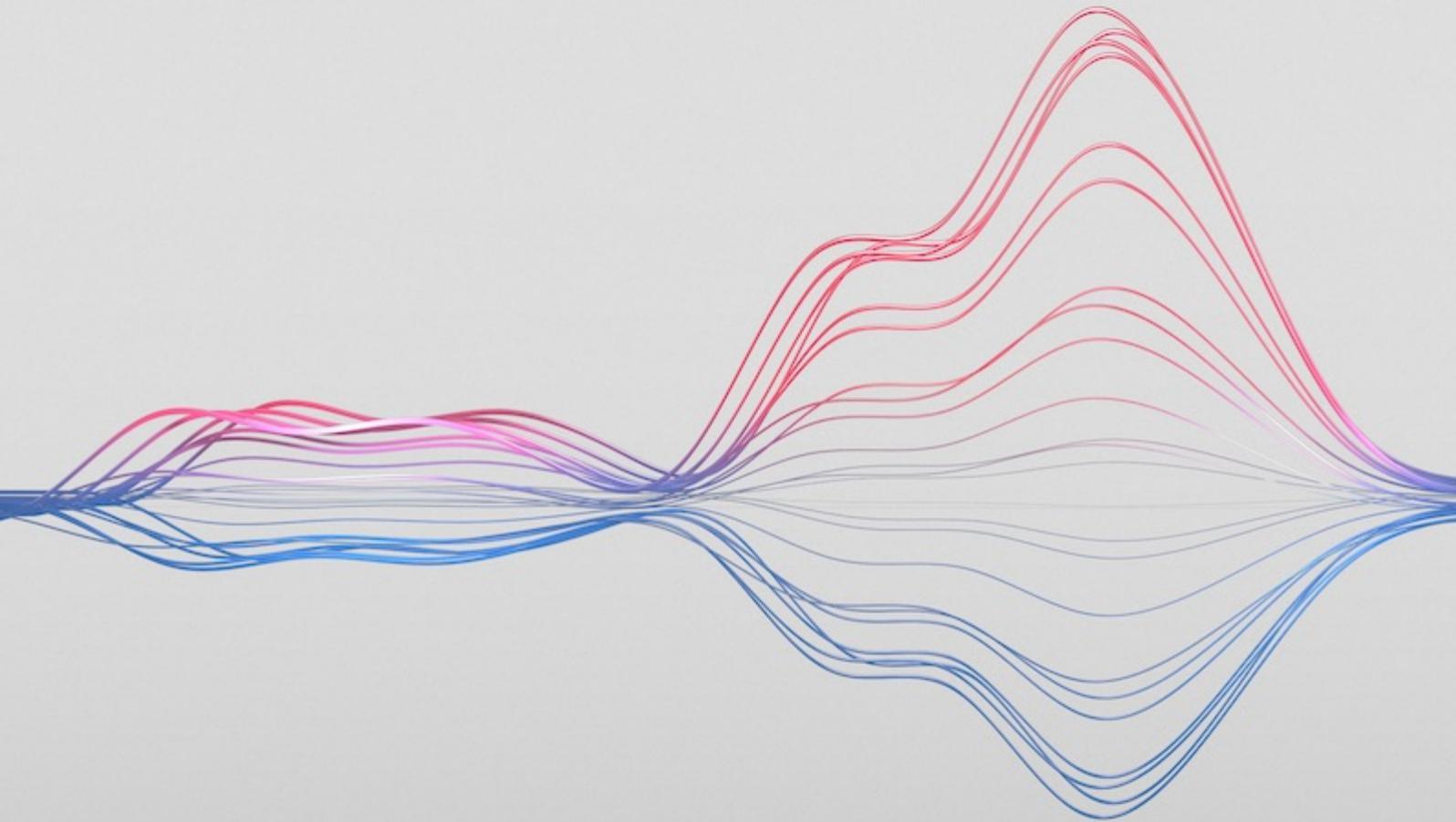


BRAZIL

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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Brazil

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General

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

Yes, although there are still quite a lot of independent, self-owned and operated hotels.

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

Common alternatives to HMAs in Brazil are:

- lease agreements;
- franchise agreements; or
- brand licensing.

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 concerning Brazilian properties are generally governed by Brazilian Law. Except for certain matters that must be governed by Brazilian law, the parties may establish another governing law, in which case it is recommended to establish an arbitration clause to facilitate enforcement of the foreign governing law.

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

Payments for services provided and licensing of intellectual property rights (royalties) are subject to different taxation based on whether the beneficiary is a resident or non-resident in Brazil.

In case of administrative and technical services provided by foreign parties, the tax burden may reach almost 50% of the amount due (net of taxes), but only a portion refers to taxes (income and service taxes) to be withheld from the non-resident and gross-up clauses are accepted. Considering the tax burden applicable to foreign entities, an alternative is to incorporate a local entity to be the services provider in Brazil.

The deduction of certain royalties (ie., trademark) is subject to limitations even (i) in transactions between non-related parties and (ii) if transfer pricing rules do not apply.

Term and termination

Is there a standard contract period of an HMA?

Terms of 15 to 30 years with one or more renewal periods are frequent, but there is no mandatory contract period.

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

The terms are usually fixed with specific early termination possibilities established in the contract (eg performance termination, breach of contract, condemnation, bankruptcy).

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

Liquidated damages and penalties for early termination are established in many cases. In others, the contract leaves damages to be established by the arbitrator/judge, as applicable. The values vary on a case-by-case basis.

What is the usual position in respect of renewal?

One or more renewal periods are common, but usually lower than the original agreement term.

Fees

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

HMAs customarily include a base fee based on gross revenues and an incentive fee based on adjusted gross operating profits.

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

Technical service fees, international chain services (marketing, reservation, etc.), software, and trademark royalties are typical in HMAs with international brands.

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

FF&E reserve requirements are standard.

Performance and operations

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

Long-term profitability with maintenance of the brand standards is a common requirement.

What performance measures are commonly used in the jurisdiction?

A percentage of the (i) budgeted operating profit or (ii) RevPAR of a competitive set.

Is an operator or owner guarantee common in the jurisdiction?

Not for the operator but depending on the project a key money is agreed. Guarantees are typically required for the owner, especially with regards to trademark marketing licenses and construction works.

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

Hotel personnel are generally employed by owners but selected, trained and supervised by the operator – except for the general manager and other key positions, which are frequently the manager's officers or employees. Owners may also have approval rights with regards to key hotel personnel.

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

Territory restriction clauses may be established for a certain term.

Who is responsible for insurance?

The owner is ordinarily required to contract insurance for the hotel property and operation. In some cases, the manager may offer the owner the option to participate in an operational insurance program, at the owner's cost.

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

HMAs do not grant *in rem* rights to operator.

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

HMAs are not recordable at the relevant Real Estate Registry Office.

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

NDA clauses are commonly required but are not subject to registration and do not bind third parties.

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

Technical Services Agreements for planning, equipping, design for construction/refurbishing of the hotel, Trademark Licenses and International Brand Services Agreements.

Transfers and assignments

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

It is common that the contract establishes that (i) transfers must be approved by the operator for asset deals (except in the case of condo-hotel sales) and limit certain share deals; and (ii) HMA transfers with the hotel.

The right of first refusal to the operator is granted in some cases. Considering that under Brazilian Law HMAs are not subject to registration at the Real Estate Registry Office and do not bind third parties, it is recommended to insert an obligation for the owner to assure the HMA assignment.

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 operator's consent is usually required for asset deals (except in the case of condo-hotel sales) and certain share deals. Requirements that the HMA transfers with the hotel are also common.

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

Right of first refusal clauses are verified in some cases.

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

Such provisions are not common.

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