

SPAIN

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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Spain

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General

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

They exist and are becoming more common; however, management agreements as drafted and imposed by international chains have never been popular among hotel owners, many of whom wish to have some involvement in the management of the property. This may explain why the penetration of international chains in Spain has not been high.

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

Real estate lease agreements are the most common alternative to hotel management agreements. They are preferred by traditional landlords and are still widely used because owners consider them to be safer and involve less management risk. In this cases, the landlord is the owner of the property, but not of the hotel business, and therefore only has to fulfil their obligations to maintain the premises and make the necessary repairs, while earning a fixed income without being subject to the risks involved in running a hotel. This is the preferred option for SOCIMIs (Spanish REITs), which can only invest in rented assets.

A modality closely linked to this type of leasing and which is used on many occasions in the tourism sector in Spain is financial leasing, whereby a financing company acquires a property intended for hotel use and transfers it to the financed party, but retains ownership of the property for a period of time and in exchange for a periodic payment. This type of contract always includes a purchase option at the end of the lease.

On the other hand, more sophisticated "industry lease" agreements – where the contractual object is determined on the one hand by the property, as a material support, and on the other hand, the business or company installed and developed therein, with the elements necessary for its exploitation – are also common in the Spanish hospitality sector, especially for more turnkey projects or assets where the operator is taking over a going concern.

Franchise agreements are also taking off in Spain.

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?

In Spain, the legislator has not specifically regulated the legal-commercial trade relations in the field of hotel management, nor has there been a detailed analysis in case law. In hotel management contracts, the principle of contractual freedom prevails; each contract will be the result of what has been agreed by the private autonomy of the parties. Additionally, the provisions of the Spanish Civil Code shall apply on a supplementary basis.

Given the importance of this contract nowadays, an attempt has been made to regulate it by including it in the proposal to amend the Spanish Commercial Code. On the other hand, HMAs in Spain will commonly be governed by Spanish law. It would be unusual for any other jurisdiction's laws to be used as the governing law.

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

HMA fees are subject to VAT. Other tax issues might depend on whether the operator was a Spanish tax resident entity or not.

Term and termination

Is there a standard contract period of an HMA?

The term of the agreement varies depending on the manager's policy or standard terms.

However, the trend in Spain in recent years, in line with international trends, has been to reduce the term of contracts or to include clauses that allow contracts to be reviewed every few years. As a general rule, for HMAs, the duration ranges from 5 to 15 years, although it is more common to agree between 10 and 15 years. Previously, these contracts were up to 25 years in duration.

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

The norm is for an HMA term to be fixed, with contractually fixed break options or early termination rights for either party, generally based on performance.

On the other hand, clauses that allow for the tacit extension of the HMA are becoming increasingly popular. In most cases, this extension is for a shorter period of time than the initial period, not reaching five years.

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).

Normally, the parties agree on a notice period of 6 to 12 months for early termination of the contract, which must be for just cause. Failure to comply with this notice period may lead to liquidated damages.

What is the usual position in respect of renewal?

Usually it is possible to agree a renewal by mutual consent, but the owner has the final say. Additionally, as mentioned above, tacit extension clauses are becoming increasingly common.

Fees

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

Generally, on the one hand, there will be a base commission for the gross revenues obtained, which will be translated into a fixed percentage of the total amount of these revenues, normally between 2% and 4%, although it will depend on the category of the hotel being managed and the type of operator. However, it is possible for the parties to make the remuneration dependent solely on the total sales of the hotel.

On the other hand, the parties may agree on an incentive fee, which corresponds to a percentage of the gross operating profit.

Finally, other fees could be added to these main fees, such as the Marketing Fee, the Direct Reservation Fee and the Non-Direct Reservation Fee.

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

Royalties sometimes apply for branded operators. Having a marketing fee is usual.

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

Yes, this is standard. The amount varies depending on type and age of asset and particular operator.

Performance and operations

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

The standard is diligent professional performance, and performance tests are set in the HMA (together with a termination right for failure to meet such tests).

What performance measures are commonly used in the jurisdiction?

Performance tests are standard, but the type and nature can vary depending on the operator, nature of the hotel, location, etc. A standard performance test would consider achievement against budget and/or RevPAR against a competitive set of local or similar hotels.

Is an operator or owner guarantee common in the jurisdiction?

Guarantees on both sides tend to be unusual.

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

The owner assumes the obligations of the employment relationship at all times and employs the labor force of the hotel, with the exception, in some cases, of the hotel manager or another employee in a relevant position with organizational responsibility, who could be employed by the operator. On the other hand, the operator has the right to hire and dismiss personnel.

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

Non-compete clauses are common and usually negotiated. With branded operators radius clauses are common.

Who is responsible for insurance?

The owner is responsible for the cost of property insurance (even if sourced by the operator) and the operator may put operational insurances in place (albeit this would be an operating expense). In any case, the operator shall take out an insurance policy to cover its civil liability *vis-à-vis* third parties as operator of the hotel.

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

Not the HMA itself. If the HMA included a purchase option on the hotel, this could be recorded in the Land Registry.

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

No, this is not possible in Spain.

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

It is not standard, but it is not unheard of, and the idea is becoming slightly more common.

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

There could be a number of different agreements depending on the operator, these include:

- (Brand) License Agreement
- Central Services Agreement
- Technical Services Agreement – on a new build or redevelopment
- Central Reservation
- Services Agreement.

Transfers and assignments

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

Given that HMAs are characterized by their long duration, operators seek to agree in the agreement that the same will survive regardless of any changes that may occur in the ownership of the company. It is now relatively common to introduce a non-disturbance clause in favor of the operator. This clause would allow the operator to have the right to continue to manage the hotel and to receive its agreed fees. On the other hand, exit fees are sometimes agreed in case the purchaser does not want to be subrogated to the owner's position.

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 to the sale is not required by law and it is rarely required in the contract, though in practice it is typical for the operator to be involved in the transaction up to a certain point as it controls most of the information on the asset.

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

No, HMAs are the preferred option for operators that opt to be asset-light and therefore they rarely ask for a possibility to purchase. Rights of first refusal are common in hotel leases, though.

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

No, operators generally try to protect themselves by including exit fees in the event that the HMA is terminated early due to the sale of the property.

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