



Newsletter

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Why do we need a non-disturbance deed between the owner, manager and financier?

Introduction

We are currently running a 10-part series discussing particular provisions and concepts within hotel management agreements.

The purpose of this series is to discuss common hotel management agreement provisions and concepts from the perspective of both hotel managers and hotel owners. Hopefully, we will touch upon one or more topics, which spark an "I've always wondered why that is the way it is but nobody has taken the time to explain it" reaction with you. We trust the discussion goes some way to demystify the topic.

Our 10-part series will cover the following topics:

1. Why is the manager's fee based on hotel's revenue and profit and not some other basis?
2. Why do some agreements provide that the manager is the owner's agent and some do not?
3. Why does the owner employ most or all of the hotel employees (and not the manager)?
4. What is the risk/reward relationship between an owner and manager?
5. Why does the owner indemnify the manager?
6. **Why do we need a non-disturbance deed between the owner, manager and financier?**
7. Why the need for an area of protection?
8. Why is the owner usually prevented from selling the hotel to one of the manager's competitors?
9. Why does the manager impose restrictions on the owner's ability to finance the hotel?
10. What is the importance of brand standards?

We should also mention that there are many partners and other lawyers in our firm scattered across the globe that have experience and expertise in negotiating hotel management agreements. These lawyers have views on all the topics discussed in this series, which may vary from the views of the authors. Today, we will continue this series with the sixth topic.

Why do we need a non-disturbance deed between the owner, manager and financier ?

Long time readers of this newsletter will be aware that we have given considerable attention to Non Disturbance Agreements (NDAs) in past editions over many years.

Generally speaking, managers insist that an owner obtain an NDA in a form, which is either attached to the hotel management agreement (HMA) or acceptable to the manager. Often however, the owner, the manager and the financier will have differing views as to the terms of an NDA.

This process may be further complicated if the financier is not known at the time the owner is negotiating the HMA and the manager's NDA requirements. Accordingly, during such negotiations, it is important for an owner to introduce a degree of flexibility in the HMA to provide reasonable latitude to deal with the requirements of its financier, whoever that may be.

The purpose of this article is to provide some points to consider in relation to the issues surrounding NDAs. The starting point to achieving a satisfactory outcome for all concerned is a consideration of the motivations of the manager, financier and owner.

Manager's perspective

From a manager's perspective, the primary purpose of an NDA is to ensure that, if the financier takes control of the hotel, it continues to recognise the manager's rights under the HMA. This requires the financier to comply with all the owner's obligations contained in the HMA.

Understandably, the manager will want its position, as negotiated in the HMA, to remain unchanged when control of the hotel passes to the financier, particularly where the manager has agreed to make payments to the owner or provide repayable financial assistance in return for being able to secure the opportunity.

The following key factors generally underpin a manager's demand for an NDA:

- preservation of rights under the HMA;
- security of term;
- ability to terminate the HMA due to owner default;
- maintenance of the manager's brand standards;
- separation and control of hotel bank accounts;
- approval rights in respect of an incoming hotel buyer and/or financier; and
- repayment of any loan or other refundable financial assistance.

Financier's perspective

Almost universally, financiers require an NDA. Financiers generally are aware of the importance of a good manager for the continued operation of the hotel, and a smooth (as far as possible) transition from owner to financier, and ultimately from the financier to a new owner.

The following key factors generally underpin a financier's negotiation of an NDA:

- continued operation of the hotel under the HMA;
- cure rights for owner breaches before and after it assumes control of the hotel;
- ability to sell the hotel asset (with as few as possible restrictions) to an incoming hotel buyer and/or financier; and
- ensuring that financial exposure to the manager only starts from the time it takes possession of the hotel.

Owner's perspective

The party, which has the least to benefit from the imposition of an NDA, is the owner. A manager imposed NDA obligation will often result in increased costs and delays in finalising the financing, especially if difficulties are experienced obtaining agreement between the manager and the financier on the precise terms of the NDA. Increasingly, however, we have seen in some jurisdictions (e.g. China), agreement reached between the parties involved expeditiously and without significant costs involved, on a streamlined form of NDA to protect their respective core interests.

The following key factors generally underpin an owner's concern when addressing an NDA:

- Ability to sell the hotel asset for the best price to an incoming hotel buyer and/or financier?

- Acceptability of a manager's NDA to a financier. If not, is there scope to permit the financier to negotiate the NDA with the manager?
- Will the NDA be generally acceptable to subsequent financiers?
- What happens if the financier and the manager are unable to reach agreement? This is particularly important if the owner intends to sell the hotel and the prospective purchaser is required to enter into an NDA with its financier as a requirement of the owner's disposal of the hotel asset. If the prospective purchaser is unable to reach agreement with its financier, what happens to the acquisition?
- Impact of an NDA on the owner's ability to obtain financing on the best possible terms?

We would be happy to elaborate on this topic to any interested reader.

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