Created by
UNITEHERE!

Seller beware: Marriott franchise agreements vs. hotel sales

Overview

Apart from operating income, a key focus of hotel ownership is on maximizing the value of the hotel asset. Whether or not franchisees have plans to sell their hotels, they should consider how being locked into a Marriott franchise agreement could impact their properties' values. To that end, this report explores four key considerations:

1. Inheriting a long-term franchise arrangement can limit the flexibility for a new owner to control operations;
2. A franchise agreement can add costs for both the seller and the buyer before, during and after a sale;
3. The franchisor may have the power to forbid a sale to the buyer of choice, or in some cases even have a right of first refusal to buy the hotel. This could scare off potential buyers; and
4. The franchisee may not have reciprocal rights if the Marriott sells the franchisee's hotel's brand.

Conditions that add expense to buying a hotel, limit the pool of potential buyers, or limit buyers' control over their assets may diminish the perceived value of the property. Hotel owners who may one day want to sell their hotels should carefully weigh the benefits of being locked into a franchise agreement with Marriott against the drawbacks.

Control over operations

Potential buyers of Marriott-branded hotels may be surprised about the extent of the franchisor's say over everything from renovation plans, to approved vendors, to everyday operational decisions. Previous FairFranchise.org reports have discussed some of these issues; those who explore their Marriott brands' franchise disclosure documents or Marriott franchise agreements will note many more.

Added Costs

A buyer of a franchised Marriott may believe they will be "stepping into the shoes" of the seller. What they may not realize is that they may have to sign a new franchise agreement[1] which may have a different cost-benefit calculus than the deal the seller had with Marriott. The sale itself also triggers a number of expenses for both the seller and the buyer that may further distort the valuation.

Although Marriott may have no ownership stake and bear little risk from the sales of its franchised hotels, the company can make several costly demands of franchisees during any potential sale. These may be significantly different from standards and costs previously imposed on the hotel. For example, the Courtyard by Marriott FDD Template Franchise Agreement provides that:

- The seller must pay the Property Improvement Plan ("PIP") fee;[2]
- The buyer must submit an application with the standard application fee.[3] The Courtyard by Marriott FDD for 2018 lists this cost as a minimum of $175,000 for existing Courtyard hotels.[4] In other words, an

application to have a Courtyard by Marriott keep its name under a new owner could cost as much as $100,000 more than an application to convert a differently branded hotel to a Courtyard.
- The buyer must satisfy whatever Marriott's owner qualifications are at the time of sale, regardless of whether they are different from the qualifications the prior owner was required to meet;[5]
- The buyer's chosen operator must be consented to by Marriott;[6]
- The buyer must sign a new franchise agreement that includes then-current fees;[7]
- The buyer must upgrade the hotel to Marriott's then-current standards; [8]
- The seller or the buyer may have to pay Marriott's legal costs connected with the transaction;[9]
- Despite all the above costs, according to Marriott, "The duration of such new franchise agreement will be the remaining term of the existing franchise agreement."[10]

In other words, the buyer will have to renovate the hotel, pay a potentially higher application fee and agree to a new fee schedule, yet end up with a franchise agreement with a shorter term than the seller had gotten for its own franchise agreement. Marriott also notes "The franchise agreement is not renewable, and you should not have any expectation that you will be granted any right to operate the hotel under our brand after the expiration of the term."[11]

Withholding Consent

According to the Courtyard by Marriott FDD Template Franchise Agreement, any time a franchisee wants to sell or transfer a Courtyard hotel, Marriott's consent is required.[12] Even if Marriott receives all of the fees discussed above, it can still withhold consent for three reasons, one of which is that "Franchisor determines that the proposed transferee's debt service or overall financial status will not permit the Hotel to be operated in compliance with the Standards;" *—Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 20 (PDF pg. 178).*

Any franchisee considering selling a hotel covered by this clause may want to ask Marriott what standards it uses to determine whether the buyer will be financially capable of complying with brand standards.

If an owner sells a hotel without Marriott's consent, their franchise agreement's language may allow Marriott to collect liquidated damages. For more information about liquidated damages, check out our previous guide.

Right of First Refusal

Franchisees should be aware of the circumstances that would trigger Marriott's right of first refusal to buy their hotels before another buyer. While these circumstances are narrowly defined, such conditions could still limit the universe of potential buyers, and by extension, constrict the asking price.

For example, the 2018 Courtyard by Marriott Franchise Disclosure Document states, "We have the right of first refusal to purchase or lease the hotel or acquire an ownership interest in you if there is a proposed transfer of the hotel to a Competitor or a proposed transfer of an ownership interest in you or your control affiliate to a Competitor."[13] Also, "Under certain termination circumstances, our right of first refusal to purchase or lease the hotel will continue after termination of the agreement."[14]

Franchisees should study how Marriott defines "Competitor" before contemplating a sale.

Franchisees lack equivalent rights

The restrictions on franchisees selling their hotels are unbalanced. Consider the following passage from the 2017 Courtyard Franchise Disclosure Documents:

> "Franchisor may Transfer this Agreement to any Person that assumes Franchisor's obligations to Franchisee, is reasonably capable of performing Franchisor's obligations and acquires substantially all of Franchisor's rights in System Hotels, without prior notice to, or consent of, Franchisee. Franchisee agrees that any such Transfer will constitute a release of Franchisor and a novation of this Agreement."
> *– 2017 Courtyard by Marriott FDD, Exhibit B - draft franchise agreement, Section 17.7(B), pg. 21.*

Under this language, if Marriott chooses to offload one of its 30 brands to a different company, franchisees have little to no recourse. So long as the above conditions are met, franchisees do not have the right to renegotiate their franchise agreements; they have no right to review the transaction, no meaningful forum to express their thoughts about the buyer, and no right to get prior notification before the transaction happens.

Endnotes

1 Template Franchise Agreement attached to 2018 Courtyard Franchise Disclosure Document ("FDD"), pg. 19-20.
2 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 19.
3 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 19.
4 Courtyard by Marriott 2018 FDD, pg. 18.
5 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 19.
6 Courtyard by Marriott 2018 FDD, pg. 92.
7 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 19-20.
8 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 19-20.
9 Template Franchise Agreement attached to 2018 Courtyard FDD, pg. 20.
10 Courtyard by Marriott 2018 FDD, pg. 92.
11 Courtyard by Marriott 2018 FDD, pg. 90.
12 Courtyard by Marriott 2018 FDD, pg. 92.
13 Courtyard by Marriott 2018 FDD, pg. 92.
14 Courtyard by Marriott 2018 FDD, pg. 93.

Ben Sadoski
bsadoski@5.unitehere.org