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COVID-19
Paul Hastings LLP
Hospitality & Leisure Client Alert

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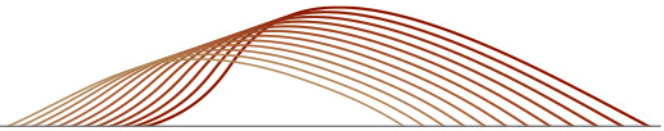
The Coronavirus – Prologue

A survey of more than 400 Global Business Travel Association (GBTA) member companies last week found that two-thirds of respondents reported cancelling meetings. The coronavirus (COVID-19) could cost the global business travel industry $47 billion in one month. The coronavirus has infected over 160,000 people worldwide and killed over 6,000. As of this writing, the United States and Puerto Rico have over 3,400 laboratory confirmed cases of coronavirus and at least 60 deaths caused by the virus, with a dramatic uptick in confirmed cases expected as testing becomes more widely available.

The coronavirus has already brought dramatic economic disruption, in particular to global supply chains and travel markets. Among other things, this pandemic will mean huge reduction in footfall, delays in hospitality construction, revising transaction documents that were near or already at completion, and a paralyzed travel sector. For both hotel owners and operators, the recently classified pandemic has created massive uncertainty around business operations.

Entire nations are imposing quarantines and travel restrictions on an unprecedented level. With both business and leisure travel severely limited, hotels and resorts, casinos, restaurants, clubs, lounges, and other major tourist locations are feeling the widespread effects, with some speculating that a recession will be hot on the heels of this virus.

How big could the decline be, and how fast can the hospitality industry recover? COVID-19 strikes at a time when hospitality supply is already greater than the demand, with occupancies down and continuing to fall. Historically, however, even after a severe decline, hotels and resorts have recovered occupancy rapidly. For example, following the SARS outbreak, some markets saw an approximately 35% decrease in demand virtually overnight, but demand recovered to near-normal levels within six months. COVID-19 is likely to follow a similar pattern. Until then, though, the hospitality market is in for some trying months. Many hotel companies have now said that due to the uncertainty related to the ultimate impact



on travel demand resulting from the COVID-19 virus outbreak, they are withdrawing their first quarter and full year 2020 guidance.

You are rightly concerned about the state of your business. In order to help you prepare for and address the coming hardships, we have prepared this Client Alert, and we intend to help navigate you through the increasingly complicated tasks of ensuring the safety of both your employees and your guests, clarifying your contractual risks and obligations, and mitigating your financial losses where possible. To help hospitality businesses around the world grapple with a wide range of questions, we have established an interdisciplinary task force to advise clients on their critical concerns and plan to provide a continuing flow of information as issues evolve. We also have created an informational hub on our firm website to share insights and resources.

Client Guide: Check your resources thoroughly and often, and take appropriate actions

The Centers for Disease Control and Prevention (CDC), the World Health Organization (WHO), and the Occupational Safety and Health Administration (OSHA) give frequent updates regarding COVID-19. They are your go-to resources for the state of the outbreak. The Equal Employment Opportunity Commission (EEOC) has released facts and guidelines for handling a pandemic in the workplace.

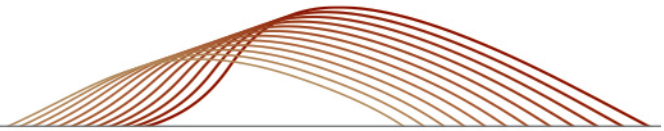
The hospitality industry is labor intensive and relies on its guests to keep businesses afloat. During this time, you will need to implement measures in your hospitality business that protect *everyone* on the premises. Be transparent with your staff and your guests about what extra measures you have taken to disinfect common areas, limit exposure, and prepare for quarantines. Complexities surrounding all of these issues are exacerbated when your hotel or other place of hospitality business are managed by a third party over whom you have little control (e.g., where a hotel is managed by a large international brand) or, to a lesser extent, leased to third parties (e.g., third-party restaurants, concessionaires, etc.).

Educate employees on the importance of following health guidelines, the symptoms of infection, and the recommended responses. According to the CDC, there are three levels of risk exposure that inform whether an employee is permitted to work onsite: **Low-Risk Exposure, Medium-Risk Exposure, and High-Risk Exposure.** The guidance is evolving on these risk factors, so we recommend you continue to track these updates to ensure any workplace decisions are well-informed.

For many companies, the virus has created a gray area regarding workplace issues like employment, health, safety, and privacy. Experts say these blurred lines underscore the value of having your legal team being involved in discussions as soon as possible. Consider making a statement addressing how you intend to assess the risks to your employees and guests while protecting your hotel or other hospitality business. Additionally, make it clear where and how an employee may confidentially self-report their health status in compliance with the ADA and other personal health laws and policies. Employees exposed to or diagnosed with COVID-19 should be directed to a designated person or department prepared to handle diagnoses and confirm with state or local public health officials without disclosing the identity of the employee.

Reminder:

1. Employers should not institute or require employees to undergo medical testing for COVID-19, unless directed by health authorities. The ADA prohibits employee disability-related inquiries or medical examinations unless they are job-related and consistent with business necessity. While there are some geographic areas where city officials are actively



encouraging taking employee temperatures, whether you do so should be carefully considered. The value of taking temperatures is debatable—as there can be false positives and infected people can be asymptomatic.

2. An employer may require an employee to leave the workplace or compel an employee to disclose a COVID-19 diagnosis if, consistent with the ADA, the employer has a reasonable belief, based on objective evidence, that the employee's ability to perform essential job functions will be impaired, or the employee will pose a "direct threat" to the health or safety of others in the workplace. Employers should follow CDC and WHO guidelines in assessing whether an employee poses a direct threat, as defined by the CDC and WHO. 42 U.S.C. §§ 12111(3), (8); 29 C.F.R. §§ 1630.2(r), 1630.15(b)(2).

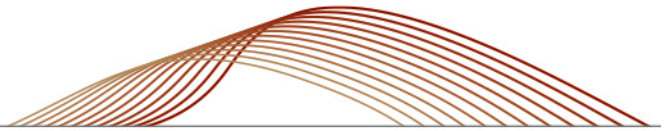
3. The CDC "strongly encourages" coordination by employers with state and local health officials when the employer is aware of an affected employee so that timely and accurate information can guide appropriate local health responses. In some circumstances, depending on the job and local health department regulations, there may be mandatory reporting obligations. OSHA has clarified that COVID-19 is a "recordable illness" for an establishment's injury and illness recordkeeping requirements when a worker is infected *on the job*.

4. Employers cannot require any employee to stay in quarantine while not at work, but where circumstances warrant, they may send home sick or symptomatic employees or prevent them from reporting to work. In accordance with the CDC guidelines described above, employers should assess an employee's level of risk exposure in order to take appropriate action and determine whether an employee may be permitted to work onsite. If feasible, telecommuting or working remotely should be considered.

Hospitality owners and operators who apply these guidelines will have *prima facie* evidence that they have taken reasonable, and not excessive, steps to protect their employees. *See, e.g.*, *Abbott v. Bragdon*, 912 F. Supp. 580 (D. Maine 1995); *U.S. v. Morvant*, 898 F. Supp. 1157, 1166-67 (E.D. La. 1995), *supra*. That does not mean that greater or lesser steps are never appropriate; however, employers should be careful to base their alternative decisions on a sound legal foundation.

The OSHA General Duty Clause requires hotel owners and their managers to furnish their employees with "a place of employment which [is] free from recognized hazards that are causing or likely to cause the death or serious physical harm to… employees." OSHA has indicated that certain OSHA standards may apply to prevent occupational exposure to COVID-19. OSHA has also published interim guidance which includes steps for classifying worker exposure as well as controls that may help protect against worker exposure.

Err on the side of caution. Senior team members for your hospitality team should encourage employees to stay home if they are unwell, which means hourly employees need to be reassured that their jobs and paychecks are safe. Marketing and sales staff should limit their travel and explore remote reservation and teleservices. In the event of a full closure, you will still need to provide reservation services for guests. Consider a code of conduct that includes hospitality habits—like hand-shaking—that should be revised during an outbreak. Also consider a health and wellness policy or a specific COVID-19 policy that requires employees to report risk levels to HR and that provides notice the hotel will report the risk to the government if and as required.



Employee and Guest Considerations: A confirmed case among the ranks

While most employees in the U.S. are employed by the manager, owners should be aware of the highly complicated employee and guest issues that will face a hotel. If a guest at your hotel exhibits symptoms or tests positive for COVID-19, you should immediately report the case to local public health officials and follow their instructions. Notify your staff and other guests, and prepare for the need to provide alternative accommodations for guests wishing to remove themselves from the premises. Additionally, increase health and sanitation measures in order to disinfect the property, and determine which guests and staff members are at risk of contracting COVID-19 because of close contact to a positive case. In the unfortunate event that your employees are affected by or test positive for COVID-19, you have a few options.

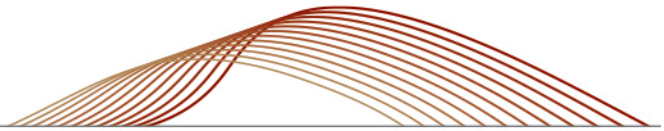
Leave and Paid Time Off

Federal legislation impacting this issue of leaves, paid leaves, and sick time is expected in the following days and weeks.[1] In the meantime, it is important to be flexible with your employees to the extent possible. This may mean arranging for alternative childcare for staff members as local schools cancel classes and re-examining your company's existing family leave policies to assist employees dealing with unexpected disruptions of childcare. Similarly, if an employee is diagnosed with COVID-19, or is immunocompromised, and has medical documentation requiring him or her to be quarantined as a result of his or her illness, an employer should consider whether working from home, a leave, or some other form of reasonable accommodation is available. State laws may vary with regard to whether employees can be compelled to use accrued vacation, paid time off, or paid sick leave under an employer's policy. Depending on the level of the injury, employees also may be eligible for short-term disability benefits.

Currently, time off for an employee to care for a family member with COVID-19 should be treated like any other leave for caring for a family member under company policy, consistent with the FMLA and state counterparts and sick leave laws.[2] Employers do not have a legal obligation to grant paid leave to employees who are unable to work due to illness, unless it is required under the employer's employment rules, the specific jurisdiction's laws, or any collective bargaining agreement with the labor union. However, it is recommended that employers review matters on a case-by-case basis, taking into account the relevant circumstances. Please refer to Paul Hastings' PH COVID-19 Client Alert Series: Employment Issues for further employee-specific guidance.

An employer may require the employee to produce a "clean bill of health" before an employee returns to the workplace after caring for a family member diagnosed with COVID-19, so long as the employer uniformly applies its policy of requiring employees on caregiver FMLA leave to provide a fitness-for-duty certification upon return from leave. Generally, employees may use sick days, medical leave, or other paid time off (PTO) options for COVID-19. Whether an employee may apply other paid time off (such as vacation or other PTO) will depend on the employer's policy and practice.

Some states are also considering action to provide for PTO benefits and/or modifying their Unemployment Insurance eligibility requirements. For example, New York Gov. Andrew Cuomo is sending a paid sick leave bill to the state Legislature that protects people who stay home from work because they are self-isolating or quarantined. Similarly, California's Employment Development Department has modified Unemployment Insurance requirements to assist persons impacted by COVID-19. Again, the anticipated federal legislation may impact all of these issues.



Wages and Hours

Non-exempt employees must only be paid for time spent working (and any pay that may be required by state or local rule, such as reporting pay). However, employees may be eligible to use paid time off available to them under the employer's policies. For exempt employees, employers should consult with legal counsel to ensure that they comply with the "salary basis" test, which may prohibit deductions from exempt employees' salaries in some cases if the employees do not substitute paid time off.

Travel

Employers cannot prohibit personal travel or other contact with family members or friends who may be infected. However, employers may encourage employees not to travel if they are sick and to exercise certain precautions consistent with CDC and WHO guidance. Employers are also free to cancel or postpone company-directed travel to reduce risk of infection of employees. Requiring employees to engage in non-essential business travel to affected areas could create OSHA risks. Therefore, employers should consider other available options (e.g., telecommuting) for employees. The CDC in its health travel notices recommends that travelers avoid "all non-essential travel" to affected areas.

WARN notification

In the event you determine it is appropriate to reduce headcount, reduce hours, reduce pay across the board, or shut down operations, even if temporary, it is critical you consider the implication of the federal WARN Act and state-specific mini-WARN Acts. States that have mini-WARN or similar legislation include: Alabama, California, Connecticut, Georgia, Hawaii, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Tennessee, Washington, Wisconsin. Although we attempt to simplify these issues for you below, these rules are highly technical, so we would recommend you obtain counsel if you decide to implement a work reduction plan.

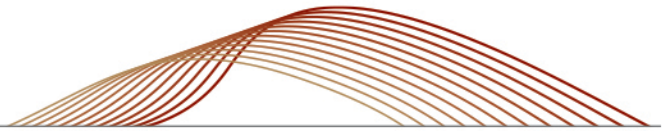
The threshold question is whether the WARN Act applies to your workforce. Generally, only employers that have 100 or more full-time employees (or the equivalent) are covered by federal WARN (fewer total employees, such as only 50 employees in New York, may cause application of a mini-WARN statute). A full-time employee is someone who works more than 20 hours per week and has been employed for 6 out of the last 12 months. Moreover, if an owner or operator owns or operates multiple hotels or other businesses located in close proximity, it should be considered whether these workforces would be aggregated.

"Employment loss" for purposes of the Federal WARN means an employment termination other than a discharge for cause, voluntary departure or retirement, a reduction in hours of work of more than 50% during each month of any consecutive six-month period, or a layoff of at least six months. Federal WARN Act triggering events (using a 90-day look back period and a 90-day forward-looking window to aggregate impacted employees) include:

1. A mass layoff (employment losses for at least 50 employees constituting at least 33% of the workforce or 500 employees, regardless of the percentage, at the site); or

2. A plant closing affecting 50 or more employees, excluding part-time employees (e.g., the closure of a restaurant within a hotel).

Employees must generally be given 60 or more days' notice (depending on applicable state mini-WARN statutes). Given that no one knows the duration of the impact COVID-19 it is advisable that notice be



given if the WARN Act triggering event might occur, irrespective of the intended duration. The notice requirements also apply to part time employees. Damages for any employer that fails to give the required notice can include back pay, benefits, and civil penalties for each affected employee for each day of defective notice, again subject to many technical rules.

The Department of Labor has not yet issued any guidance on whether one of the exceptions to WARN will apply to the COVID-19-induced hospitality downturn, mitigating any damages for failure to give advance notice. It is critical to understand that this exception does not excuse giving notice; rather, it excuses giving 60 days' advance notice.

- One exception under Federal WARN is when there is an "unforeseen business circumstance." This is generally defined as a "[plant] closing or mass layoff [that] is caused by business circumstances that were not reasonably foreseeable at the time that 60-day notice would have been required (i.e., a business circumstance that is caused by some sudden, dramatic, and unexpected action or conditions outside the employer's control, like the unexpected cancellation of a major order)." While this exception often will apply to Coronavirus-related layoffs, hotels should plan that to bear the burden of proving why they could not provide statutory notice. It is critical to understand this exception is not recognized in every state, such as California, and therefore cannot act as a complete defense to WARN act matters.

- The Federal WARN Act also has exceptions for business actively seeking business or capital and natural disasters, either of which may apply depending on the circumstances and judicial interpretation. Many states have similar exceptions, such as for "physical calamity or act of war." Each state's interpretation can vary, however, making it equally important you analyze the applicable laws carefully as far in advance as possible.

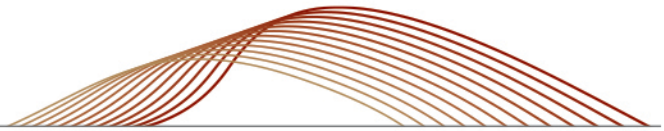
Reduction contemplated

Whether in connection with the foregoing or in an effort to stem the tide of operating losses due to low occupancy, when considering what type of reduction is most appropriate for your hotel, there are multiple options to consider including offering reduced pay, voluntary time off, forced reduction of hours, furloughs, and layoff. Messaging to employees must be done in a culturally-appropriate manner for your particular hotel and risk factors.

If your hotel is considering a reduction in hours across the board, including exempt staff, determine whether exempt duties will be passed to someone else. It is critical to ensure the reduced-hours job will be performed in an exempt manner. Additionally, sometimes, when an employee works reduced hours, the employer unwittingly cuts the salary below the salary minimum under the FLSA or state law. It is recommended that the reduced salary does not fall below those thresholds.

Safety Concerns

A hotel has an obligation to protect the safety of its employees and guests. This includes the obligation to take measures to protect employees from sources of danger within the workplace and to ensure that the hotel is a safe environment. While there is no specific standard under federal OSHA laws that addresses COVID-19, the OSHA General Duty Clause requires employers to furnish "a place of employment which [is] free from recognized hazards that are causing or likely to cause the death or serious physical harm to… employees." Employers should review their health and safety policies and procedures, federal and state guidance, evaluate the risks of exposure to employees, and take reasonable steps in accordance with guidance, including the consideration of engineering controls (e.g.,



installation of physical barriers, increasing ventilation rates), administrative controls (e.g., minimizing close contact among employees, staggered or alternating shifts, discontinuing non-essential travel), safe work practices (e.g., hygiene, training), and the use of personal protective equipment ("PPE") to protect employees. If an employee contracts COVID-19 in the workplace because of a failure to comply with the employer's obligation to protect employee safety and health, the employer may be held liable for civil or even criminal liabilities**,** and there may be a recording obligation on your OSHA 300 log. Some states have also enacted guidance to address safety concerns surrounding COVID-19.

- OSHA has issued specific guidance on preparing workplaces for COVID-19, including meaningful steps that can be taken to reduce risk: https://www.osha.gov/Publications/OSHA3990.pdf

- The CDC guidelines for employers concerning COVID-19 include encouraging sick employees to stay home, separating them from other workers, encouraging hygienic practices at the workplace, performing routine environmental cleaning, and advising employees to take certain steps before traveling (including potential postponement of travel). The CDC also has issued employer guidelines for risk assessment (discussed below).

- The World Health Organization ("WHO") guidance and protocols (including Strategic Preparedness and Response Plans) related to COVID-19.

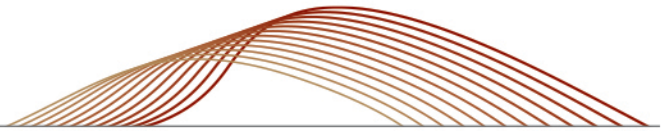
- The EEOC's guidance for employers on Pandemic Preparedness in the Workplace. While not specific to COVID-19, this guidance illuminates general considerations for employers during contagious disease outbreaks.

Even if an employer takes all reasonable steps and follows OSHA and CDC guidance, employees may nevertheless express safety concerns and/or refuse to report to work as a result of such concerns. It is critical that employers review anti-retaliation policies under OSHA and state laws prior to taking action in response.

We understand it can be particularly challenging to consider what to do with guests presenting with COVID-19 symptoms or who are subsequently confirmed. As with other health issues, employers ***should not*** disclose the identity of the guest (outside of those addressing the treatment of the guest, which in such case should be limited to the room number to the extent possible). Instead, the hotel can inform potentially affected employees that an unidentified guest with whom they have had recent contact has tested positive for COVID-19 and they should monitor themselves for the development of symptoms, including potentially seeking medical treatment.

In partnership with your public health officials, a hotel may require a guest to vacate the hotel if, consistent with the ADA and the hotel's past practices of dealing with infectious diseases, the hotel has a reasonable belief, based on objective evidence, that the guest will pose a direct threat to the health or safety of others in the workplace. Whether an individual poses a "direct threat" depends on: (i) the duration of the risk, (ii) the nature and severity of the potential harm, (iii) the likelihood that the potential harm will occur, and (iv) the imminence of the potential harm. A hotel should consider the level of risk posed by the guest in light of the CDC's risk factor levels.

If it is determined the individual will stay in containment in your hotel, consider following OSHA guidelines for prompt identification and isolation of potentially infectious guests to ensure your other guests and employees are protected from exposure:



- Immediately isolate guests suspected of having COVID-19. Request that the guest not leave their room. Use disposable food containers to make delivery and removal of any room service seamless. Inform the guest that housekeeping will not be performed during the duration of the guest's stay; however, it would be prudent to develop a system to allow exchange of used linens.

- Protect employees in close contact* with the guest by using additional engineering and administrative control, safe work practices, and personal protective equipment ("PPE"). **CDC defines "close contact" as being about six (6) feet (approximately two (2) meters) from an infected person or within the room of an infected guest for a prolonged period while not wearing recommended PPE. Close contact also includes instances where there is direct contact with infectious secretions while not wearing recommended PPE. Close contact generally does not include brief interactions, such as walking past a person.*

- Proactively develop a removal process for infected guests by working with an area medical facility and your local public health official.

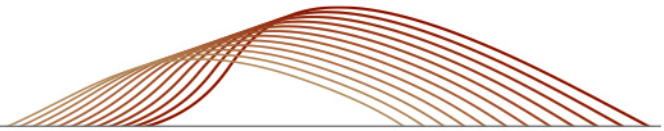
Operations, Construction Interruptions, and Protections

Transactions and Construction

Multiple institutional clients have informed us that their investment committees have decided to suspend any hospitality investments for the time being—even where there are executed purchase agreements with "non-refundable" deposits. If you are a seller, expect to see requests for delays/postponements of closings of hotel and other transactions, and buyers walking from deposits or terminating purchase contracts and attempting to retain their deposits. Similarly, we are all but certain to see widespread requests by borrowers for changes to loan agreements as the negative impacts of COVID-19 spreads throughout the hotel industry. It is also likely that banks will suspend the borrowing of money for any acquisitions.

Purchase and sale agreements for hotels often include a blanket covenant requiring sellers to operate the target business in the ordinary course during the period from signing to closing of the transaction and requiring the consent of buyer with respect to changes in operations—these covenants may impair the seller's ability to take swift action in response to a disease outbreak at a property or other similar local, national, or global exigent event. Although buyers will be focused on preserving the value of the target business they intend to purchase, in light of the COVID-19 outbreak and the associated risk to human health and safety from this outbreak, sellers should preserve their ability to respond and react to these events without needing to obtain a buyer's consent or risk breaching a covenant. Accordingly, a seller's obligation to operate the target business in the ordinary course should still allow the seller to take reasonable action to (i) comply with requirements under applicable law or WHO recommendations, (ii) protect human health and safety and (iii) make changes to minimize operating losses resulting from the COVID-19 crisis.

Projects that have a residential component have an added layer of concerns. Where projects are not yet completed but residences are under a purchase contract, the developer should expect some fallout from the buyers, particularly if there is a decline in market prices. Sometimes buyers will try to get out of their contracts even if they have no right to do so. Developers will need to review their contracts for such issues. For projects that are completed with owners occupying residences adjacent to or in the same building as the hotel, the impact on the residences by disruptions or reductions in services and by guests who may potentially be infected with COVID-19 should be considered.



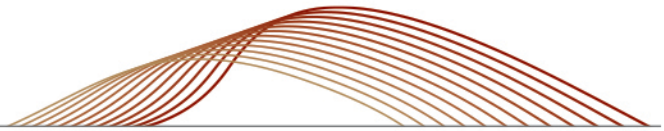
With regard to construction, according to Dun & Bradstreet, at least 51,000 companies worldwide—163 of them Fortune 1000 companies—have one or more direct suppliers in regions most seriously hit by the virus. With so much of the damage caused by the virus being concentrated in Asia, there will likely be disruptions in the supply chain for construction of hotels and other hospitality businesses in the U.S. Significant quantities of construction materials come from China, so a 30–45 day delay in delivery targets for supplies in the U.S. should be expected.

Insurance

With businesses of all sizes being hit by the financial effects of COVID-19, owners and operators are reviewing their insurance policies for relief. In order to take advantage of your corporate policies, take stock of what you have. Some policies will contain specific language that relates to COVID-19 losses by addressing *pandemics* and *communicable diseases*, as well as *event* and *booking cancellations*. Most importantly, you should not assume your insurance will cover you. You may or may not have coverage that applies to public health emergencies. Review everything carefully to know the extent of your options. Many businesses may have overlooked this type of coverage at policy inception because of the unlikelihood of needing it. You should turn to your commercial property insurance and review your coverage for the following:

- **Labor Coverage** – This coverage will address costs incurred to protect/preserve your business.
- **Contingent Business Interruption Coverage** – This coverage applies to situations in which your business suffers losses due to damage and interruption of your suppliers and vendors.
- **Business Interruption Coverage** – You are likely to lose profits during the coming months as bookings disappear and conferences cancel, and business interruption insurance can offset the costs for a covered event.
- **Civil Authority Coverage** – This coverage may apply where a local government issues mandates or ordinances that prohibit guests and employees from reaching your property.
- **Ingress/Egress Coverage** – This coverage may apply where employees or guests are unable to access the property because of "insured peril"—in other words, danger.
- **Extra Expense Coverage** – This coverage will help your business continue running in the event that operations suffer a significant loss.

With respect to transactions, hotel owners, whether buying or selling, should ensure they understand their responsibilities pursuant to acquisition agreements for, and the extent to which any rights against third parties (e.g., insurers) may offset, losses to their properties arising from the spread of COVID-19. You may have insurance that usually pays out when you incur a halt in operations, but that oftentimes applies only in cases of physical damage, not epidemics. Your coverage may even explicitly exclude coverage in the event of an epidemic. Buyers must consider whether an acquisition's existing insurance coverage covers potential losses it may experience as a result of the virus, and if that coverage will remain in place post-closing. Arguably, business interruption insurance is only available if your hotel has been closed by the government or a person who was otherwise to be an attendee or a guest is diagnosed with the infection and the group cancels as a result thereof. It may be up to the courts to decide to what extent insurers are obligated to pay hospitality providers for their losses in the aftermath of COVID-19.



In the meantime, issue your claims carefully but quickly, and understand that the crisis is fluid. This may only be the beginning of what could be a battle between policyholders and providers. Insurance companies will want to settle claims quickly, so be sure to account for the long-term damages your hospitality business may experience.

Material Adverse Effect (MAE)

Buyers of hotels and other hospitality businesses may seek protections through "Material Adverse Effect" (MAE) or like term provisions and/or a corresponding closing condition that would permit them to terminate a land or property acquisition agreement without liability to seller in the event circumstances surrounding COVID-19 or similar outbreaks deteriorate further.

Sellers should seek carve-outs in the MAE provisions for any epidemic, pandemic, or disease outbreak (including the COVID-19 virus) in addition to the litany of other exigent circumstances typically carved out from MAE provision.

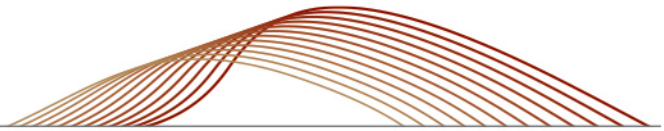
Buyers and their financing sources should anticipate that sellers will push for buyers and their financing sources to bear the risk of any adverse consequences caused by COVID-19 by expressly excluding "pandemic" (and similar terms) in the definition of MAE in acquisition agreements.

Unlike in the case of committed financing, agents and lenders will have more flexibility to decline to fund in the event of a company's material decline in performance. Clients should discuss risks with making any "Material Adverse Effect" representation at closing and in connection with the bringing down of such representations after closing.

Hotel Management and Franchise Agreements

Given that occupancy levels are likely to drop significantly and many hotels will need to reduce or completely shutter operations for several weeks to months, hotel owners should carefully review their hotel management and franchise agreements, as applicable, to assess rights with respect to the following critical issues:

- Closing the hotel: Many hotel management agreements include specific authority for an owner and/or manager to close the hotel in the event of a force majeure.
- Re-reviewing budgets in light of changed circumstances from when the budget was adopted: While certain agreements include express rights for a manager to submit a revised budget in the event of a change in circumstances, owners should be proactive in discussing with managers necessary updates to the budget given that occupancy and revenue is likely to significantly drop at the hotel. All options should be on the table with respect to reduction of operating expenses and deferral of non-essential capital expenditure programs in order to preserve as much value as possible.
- Insurance provisions: Owners should pay particular attention to business interruption insurance provisions, but should also examine any insurance coverage that it may have in the event that guests or employees became ill at the hotel and are seeking recourse against owner and/or the manager.
- Performance tests: It is unlikely that managers will be able to satisfy their performance test metrics, particularly the standard "Gross Operating Profit" and/or RevPAR tests. Many hotel management agreements provide that either the entire year will be discarded or the test will



be equitably adjusted. In the event of an equitable adjustment, Owners should work with operators and experts (if necessary) in order to equitably adjust performance metrics to account for the adverse effects of COVID-19 on operational performance.

- Condemnation: In the event that the government orders hotels to be shutdown, owners should understand their rights with respect to condemnation proceedings and the effect on the management agreement, including whether the hotel manager can be terminated and if owner would have to pay any termination fees.

- Indemnity: Owners should carefully review, in connection with the insurance provisions, all of owner's obligations with respect to indemnification. Typically, owners are required to indemnify managers for everything that occurs at the hotel with the exception of a manager's gross negligence or willful misconduct. If a fact pattern arises where manager is being grossly negligent or exhibiting willful misconduct (e.g., manager knew that a guest was infected with COVID-19 and allowed the guest to remain at the hotel), the owner of the hotel should assess whether any liability that arises should be shifted to the manager.

- Given that this is an extremely challenging and difficult time for everyone (including owners, managers, employees, and guests), owners should work closely with managers to monitor the situation and cooperate in a manner that produces the best results for all parties involved.

Service Agreements

Review your service agreements. Cancel and renegotiate all recurring service agreements where necessary, and lean on your vendors. You have been a valuable customer in the past and they will want to keep your business when the market returns to normal.

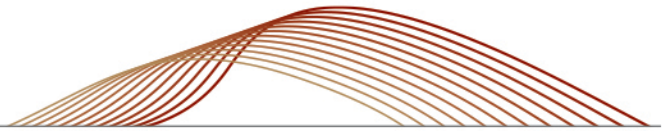
Force Majeure and Increased costs

Studies suggest that conferences in the U.S., with a combined expected attendance of 286,000, have been canceled for March, which may lead to 969,000 lost room nights. Hotels can expect 50% recouped bookings, and existing conventions are seeing 20% to 30% declines in attendance. How can you recover some of this lost income?

Force Majeure is relevant both for hotels and resorts, as well as for the groups that have booked contracts there. Please refer to Paul Hastings' COVID-19 Client Alert Series: Contracting, Performance and Litigation Risks for further *force majeure* guidance.

Booking

Hotel owners and operators should review with counsel the terms of any existing contracts that may be impacted by COVID-19. Parties that find themselves contractually disadvantaged by the effects of COVID-19 may seek to invoke *force majeure* or "act of God" clauses to excuse continued contractual performance. Typically, for *force majeure* to apply, the event that triggers enforcement of the clause must fall within the scope of contractually defined *force majeure* events, be out of the parties' control, not be caused by a party's own fault or negligence (e.g., natural disasters, political acts, or terrorism), and sometimes requires impossibility of performance. Clearly declared state of emergencies and regional quarantines and/or bans on gatherings of more than x number of people might result in violation of law if not stronger arguments of impossibility.



When an intervening act occurs, the party invoking the *force majeure* clause as a defense for nonperformance generally bears the burden of proving that the event was actually beyond its control. If COVID-19 does not constitute a *force majeure* event under the particular agreement at issue, parties can still potentially claim impossibility, impracticability, or frustration of purpose. The availability of these contractual defense doctrines will vary by jurisdiction.

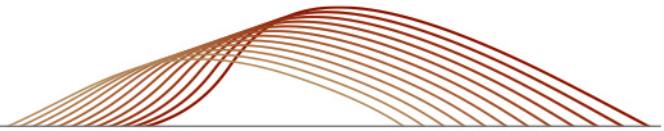
For example, in New York, "the excuse of impossibility of performance is limited to the destruction of the means of performance by an act of God, *vis major*, or by law." In turn, impracticability generally requires a showing that the non-occurrence of the event was a basic assumption of the contract, continued performance is not commercially practicable, and that the party claiming discharge did not expressly or impliedly agree to performance despite the impracticability. Similarly, frustration of purpose is available where there is substantial frustration of the principal purpose of the contract, the non-occurrence of the frustrating event was a basic assumption underlying the contract, and the party invoking the doctrine is not at fault.

Importantly, the mere occurrence of unfavorable economic conditions (bans on travel, for example) brought on by coronavirus or market shifts may not qualify as *force majeure* or other events that excuse performance. In the same vein, difficulties in operation of a hotel due to circumstances outside of a party's control may not lead to recoverable damages. Courts have observed that "the parties to any contract to be performed over a term normally assume that the cost of performance may fluctuate during the term, and, as a result, courts ordinarily do not conclude that an increase in the cost of performance is an event the non-occurrence of which was a basic assumption of the contract." Despite the foregoing, there is some precedent for the proposition that a party's continued performance can be excused as impracticable where there is a substantial difference in the expected versus actual cost of performance because of an extraordinary intervening event.

In some jurisdictions, one cannot invoke the defense of impracticability where a party's performance is dependent on some act by a third party. One court specifically mentioned that a party to a contract which cannot be performed without the consent or cooperation of a third person is not relieved of liability because of such party's inability to secure the required consent or cooperation. For example, a hotel may not be able to claim its operations are impracticable or impossible because of its guests' high cancellation rates. Essentially, cancellations are an assumed risk.

Landlord / Tenant issues

Most commercial leases are designed to protect the landlord from claims for rent abatement or for possible termination benefiting the tenant, even in difficult circumstances, and commercial leases, as a general rule, are most often enforced in accordance with their terms. Perhaps the most vulnerable commercial leases in this area, however, would be certain forms of retail and/or restaurant leases which are substantially or wholly dependent on percentage rent (leases where the primary or sole source of income for the landlord is a percentage of the tenant's gross revenues). Dramatically lower sales and /or revenue volume has already become a serious problem for retail and restaurant tenants in Asia and Italy, and appears to be a growing problem for such tenants in California, New York, Washington, and other jurisdictions having a higher incidence of COVID-19 cases. These retail and restaurant leases often will have operating covenants designed to compel the tenant to remain open, but the primary remedy for noncompliance with such covenants, termination of the Lease, is not likely to be useful under current circumstances. To the contrary, in Hong Kong and Mainland China, many landlords, fearful of losing their retail and restaurant tenants, have been offering voluntary rent abatement to support their tenants.



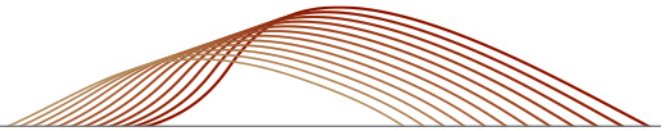
Depending on the circumstances, several other lease provisions may apply. In limited circumstances, also offer some support for tenants seeking relief. The first such provision is the damage and destruction provision, which may provide rights for the tenant to abate rent, and in some circumstances, rights to for the tenant to terminate the lease. It is not currently customary for such provisions to define the requisite "casualty" or "damage" event to include external events which do not physically damage the premises, access to the premises, parking facilities, or other supporting improvements (thus, physically interrupting operations), but there may be some potential in tenant-favorable jurisdictions for aggressive judges to seek to stretch the coverage of conventional damage provisions to cover the current pandemic. Based on these wholly new experiences, landlords should anticipate that major retailers/restauranteurs with market leverage may be modifying these provisions in future leases at least to provide some form of rent relief for pandemic circumstances.

In addition, a related provision with some potential for application (particularly in the future) would be those provisions (typically found only in leases of tenants with greater market leverage) focusing on "interruptions," and providing rent abatement (and, sometimes in extreme cases, tenant rights of lease termination) for interruptions in the tenant's operations, normally after the passage of a threshold period of interruption. Again, normally such provisions apply only to physical interruptions in operations due to disruption of utility service, interference from physical construction and the like, sometimes with the requirement that such interference be accompanied by some level of landlord fault or negligence in causing the disruption. While one should anticipate that future tenants with leverage will add epidemic and similar non-physical interruption events to their version of these clauses, absent more extreme language, it is probably unlikely that current provisions would be sufficiently broad to provide relief for interruptions due to a pandemic.

Loan and Debt Service Issues

Many or even most hotel borrowers will be cash starved through any period of quarantine and, therefore, they will have no choice but to ask their lenders for forbearance. While balance sheet lenders will often decide to grant forbearance based on past relationship, that will not be the case with CMBS loans. Generally a loan can only be modified by the special servicer (as opposed to the master servicer) and, other than maturity defaults, there is usually a 60 day period after a default before the loan is transferred to special servicing. The borrower could request an earlier transfer, but there are significant fees that are incurred once a loan is in special servicing. Once in special servicing, the special servicer is not incentivized to be borrower friendly as any economic hits on the loan are borne by the most subordinate portions of the securitization trust, which are often associated with the special servicer. Often times, the situation is counterintuitive, meaning that the worse the situation the more likely the special servicer is to take action. If a situation is not ire, then a special servicer is more likely to wait it out as opposed to modify the loan. The first avenue that they will push for is for the sponsor to come out of pocket to pay the debt service. But there is really no reason for the special servicer to grant forbearances or allow interest to accrue, etc. unless the situation merits a restructuring and the borrower is coming with a legitimate business plan to fix the property/loan.

Note also that, due to operating covenants and other loan restrictions, closing your hotel due to low occupancy will likely also require lender consent, as will an amendment or termination of hotel management or franchise agreements. While you may have a grace and cure period or be able to argue *force majeure* or the public policy and equitable principles described above, you will need to consider the implications of this potential default (even if debt service is being paid current).



You should also keep in mind that most non-recourse carveout guaranties require guarantors to backstop real estate taxes and insurance premiums (subject in some cases, to certain limitations). Other concerns would include potential claims of waste (if you close your hotel and do not adequately secure and maintain it), misapplication of business interruption proceeds and potential liability for key money in the event that hotel management agreement or franchise agreement is terminated.

Notices

All contractual notice provisions should be carefully scrutinized to determine whether COVID-19 triggers any notice requirements. If a party's communication expressly or impliedly indicates that it will not perform under the contract, the non-breaching party can elect a number of different remedies, including rescinding the contract or treating the repudiation as a complete breach.

Buyers faced with notification of a material or indefinite delay that substantially impairs the value of the whole contract may be able to terminate and discharge any unexecuted portions of the contract or modify the contract by agreeing to a substituted performance.

Your reputation

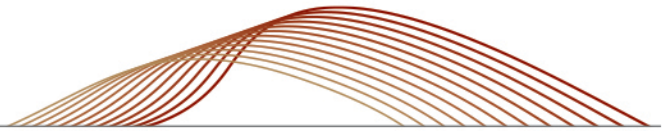
The COVID-19 outbreak is already having a significant impact on the hospitality and tourism industry. Fewer people are traveling, and the cancellation of their reservations means a loss of income and potentially loss of jobs for your employees. However, a decrease in lodging occupancy may provide an opportunity to reexamine your sanitation guidelines, sick and leave policies, and employee healthcare. There are certain inevitable consequences of COVID-19 on your business, but you should avoid adding to the problem by establishing a poor reputation among the traveling public and your current and potential workforce. You may want to review your policies and upgrade them where necessary.

Be aware. Listen to your local and public health officials, and know your boundaries. For example, California has declared a state of emergency with respect to COVID-19, but this does not impose specific restrictions on private businesses like hotels and resorts, restaurants, and other hospitality providers.

Be clean. Encourage employees and guests to follow all guidelines, including hand washing policies, increased sanitation and disinfection plans, and social distancing measure when required. Additionally, check your ventilation systems and windows. Clean air is a must. Enhance your current facilities cleaning procedures accordingly including installing hand sanitizers in key areas.

Be flexible. Your guests were hoping to enjoy and to take their vacations. Companies sunk a lot of money into their conferences. Your employees were depending on their paychecks and healthcare. Flexible cancellation and scheduling policies will go a long way to recovery. Reassure everyone on your properties that you are prepared to protect their health, but that public officials may discourage or outright prohibit travel. Make rescheduling and refunds as convenient and transparent as possible. Consider (clear and temporary) revisions to cancellation policies, such as: "For any reservation booked between today and (4 weeks from now), the cancellation window will be shortened to 10 days out, and deposits will be fully refundable."

Be practical. Hope for the best, but prepare for the worst. Plan for major disruptions; planning ahead will increase your economic viability in the long run. Publish your plans online and in your facilities using social media, email, and websites. Don't forget about your foreign guests! Share information in multi-



lingual formats, and remind everyone that you will be providing updates regularly. Let them know who they can contact with questions or concerns about their reservations or the safety of the facility.

Be prepared. Train your front desk to be compassionate but firm when guests ask about the virus and express concern about their travel. Review your monthly operational expenses and service agreements to assess your risk during a contracted travel season, especially with spring break and summer travel being heavily affected. Implement a preparedness plan and communication protocol. Consider providing materials or personnel in various relevant languages.

What to expect

Globally

Major hotel companies have temporarily shuttered hundreds of locations in China this year, and stocks of publicly listed hotel brands have plummeted since February. One hotel brand has said it is waiving cancellation fees for hotel stays through March 31 for guests traveling to or from locations including mainland China, Hong Kong, Singapore, Japan, South Korea, Australia, and Italy. Other hotel companies are trying to accommodate guests by not charging cancellation fees and not letting loyal customers' preferred status lapse if they do not visit properties as often as they normally would.

Investment (Opportunities)

When WHO identifies a market as having an outbreak—or, in this case, identifies an outbreak as a *pandemic*, which means a global market effect—hoteliers will likely see a significant but short-lived and relatively shallow impact on demand. Short term negative impacts can create investment opportunities. With share prices in public REITs having plummeted, there are buying opportunities for assets owned by such REITs.

Lenders are being cautious right now as they assess profitability in a volatile climate. Some lenders have suspended work on hotel deals; others have terminated negotiations on term sheets/commitments. Remember, while lenders tend to focus on your trailing 12 months' performance to underwrite to a stabilized value, the truth is that they care more about the next 12 months. Interest rates will likely remain low for the foreseeable future, so positioning yourself to take advantage of this could create value for hotel deals. Expect a domino effect.

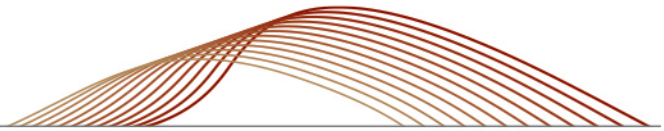
Spencer Levy, chairman of Americas research and senior economic advisor for CBRE recently said: "We believe that if and to the extent that you do see a modest downturn in deal volume in the short term because of travel restrictions or people having difficulty underwriting assets, as we saw with the SARS epidemic in 2003, post-Brexit, and then post the Trump election, we do believe they will be picked up for later in the year as we saw in the other events."

Pivoting

Turn your marketing local. Re-evaluate where your guests are coming from: The rise of the staycation is a likely prospect given that the cancellations of international flights are taking place in the height of spring break travel, school graduation trip planning, and summer vacations.

About Paul Hastings

Paul Hastings provides innovative legal solutions to many of the world's top financial institutions and Fortune 500 companies in markets across Asia, Europe, Latin America, and the United States.



We offer a complete portfolio of services to support our clients' complex, often mission-critical needs—from structuring first-of-their-kind transactions to resolving complicated disputes to providing the savvy legal counsel that keeps business moving forward.

Since the firm's founding in 1951, Paul Hastings has grown steadily and strategically along with our clients and the markets we serve. We established successful practices in key U.S. and European cities, creating a broad network of professionals to support our clients' ambitions. In addition, we were one of the first U.S. law firms to establish a presence in Asia, and today we continue to be a leader in the region. Over the past decade, we have significantly expanded our global network of lawyers to assist our clients in financial centers around the world, including the emerging markets of Latin America.

Today we serve our clients' local and international business needs from offices in Atlanta, Beijing, Brussels, Chicago, Frankfurt, Hong Kong, Houston, London, Los Angeles, Milan, New York, Orange County, Palo Alto, Paris, San Diego, San Francisco, São Paulo, Seoul, Shanghai, Tokyo, and Washington, D.C.

Drawing on the firm's dynamic, collaborative, and entrepreneurial culture, our lawyers work across practices, offices, and borders to provide innovative, seamless legal counsel—where and when our clients need us.

Paul Hastings Global Hospitality & Leisure Practice

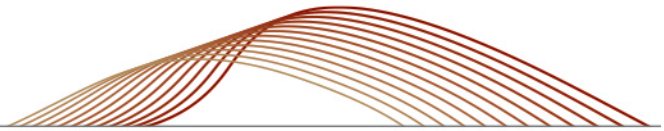
Our Hospitality & Leisure practice offers clients the benefit and reassurance of our unparalleled industry experience. We are well known for providing interdisciplinary legal counsel to major participants throughout the industry on virtually every type of Hospitality & Leisure project. We closely monitor trends (and crises) in markets around the world and draw on our decades of industry experience to help our clients adapt to the evolving real estate landscape.

Full-Service Legal Counsel for the Hospitality Industry

Our Hospitality & Leisure group brings together a global roster of lawyers dedicated to the legal and business needs of real estate development companies, institutional lenders, investment banks, capital providers, owners, and operators in the hospitality sector. We assist our clients with the development, acquisition, sale, finance, leasing, operation, management, licensing, branding, repositioning, roll-up, foreclosure, workout, and restructuring, of hospitality, recreational, and real estate-based entertainment properties, and businesses in markets around the world.

We advise our clients on every type of hospitality and leisure project, including:

- Hotels
- Condo-hotels
- Resorts
- Branded condominiums
- Private residence clubs and timeshare projects
- Fractional jets
- Spas



- Restaurants
- Casinos
- Golf courses and country clubs
- Tennis stadiums
- Theme and amusement parks
- Yachts
- Fishing, shooting, and vineyard-based leisure activities

As a result, we have deep firsthand expertise in the negotiation and structuring of every type of legal document involved in such projects, from purchase and sales contracts to ground, office, restaurant, and retail leases, to limited partnership and joint venture agreements, to construction, engineering and architectural contracts—and everything in between.

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[1] *See Making emergency supplemental appropriations for the fiscal year ending September 30, 2020, and for other purposes*, H.R. 6201.

[2] Again, proposed federal legislation may impact this analysis. *See Id.*