Dealing With An Unwelcome Guest – Coronavirus and Operating, Contract and Loan Issues for Hotel Owners and Operators

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The Hospitality industry stands on the front lines of the growing concern over the spread of Coronavirus Disease 19 (“Covid-19” or “Coronavirus”). As an industry focused on serving the needs of travelers from varied and often distant locales, in facilities that see significant daily guest turnover, and as hosts to guests for conferences and events, the risks to hotels from the Coronavirus may be particularly acute. The news is filled with daily reports of major conferences being canceled, businesses curtailing employee travel, and individuals reducing personal travel, all of which impacts hotel operations and performance. Following is some advice for hotel owners and operators to consider in these circumstances:

Response Planning

Hotel owners and operators should discuss creating and implementing a flexible response plan to dealing with the Coronavirus, with focus on guests, employees, and the facilities. The Centers for Disease Control and the Occupational Safety and Health Administration have both provided guidance on crafting response plans.
Both agencies recommend that a written plan be developed by businesses that takes into account potential Coronavirus exposure to employees and guests and potential interruptions in supplies, and taking proactive steps aimed at reducing the probability of Covid-19 transmission. The plan should be communicated to all hotel employees, and hotels should consider communicating certain aspects of the plan to guests and visitors. OSHA also recommends that a point person or committee be established that is responsible for implementing, overseeing and adapting the plan as facts and circumstances evolve.

For example, a hotel’s response plan could include some or all of the following measures (in a phased approach):

- Placing hand sanitizer in all public areas; offering hand sanitizer at check-in; no handshakes with guests
- Adding hand sanitizer to all guest rooms; increased cleaning of door handles, elevators buttons, touch screens; designating an employee to focus only on sanitizing
- Increased cleaning of restrooms and public areas; providing housekeeping service only upon request or at checkout; switching from reusable to single-use glassware and silverware in guest rooms
- Closing hotel amenities (like fitness centers and pools); adjusting the staffing mix between salaried and hourly employees

Any plan must take into account employee contracts, collective bargaining agreements, and applicable local, state, and federal laws and regulations. Hotels should consider involving counsel when developing and modifying the plan to review it for compliance with laws and regulations.

**Contracts and Force Majeure**

As concern over Covid-19 continues to grow, hotels may see cancellation of conferences and meetings, and guests seeking refunds of non-refundable fees and deposits, potentially based on a claim that the Covid-19 outbreak constitutes a force majeure event. A force majeure claim by its nature is dependent upon the facts and circumstances in question and the specific contract language that addresses force majeure. Force majeure is generally thought of as an event that makes contract performance so difficult as to be impossible, or actually incapable of performance. Contract clauses that focus on force majeure may contain very specific language that defines what type of event can constitute a valid force majeure event, as well as notice periods for such claims, mitigation obligations, and remedies. In connection with any cancellations asserting force majeure due to the Coronavirus, hotel owners and operators should carefully review force majeure clauses in their contracts to determine if such cancellation falls within the scope of the clause, and if not, what remedies they have available for a breach of the contract.

**Impact on Budgets and Loans**

Another area of focus for hotel owners and operators is the impact that Covid-19 will
have on property budgets and loan document covenants. As business travel and tourism decline, hotel revenues will likely take a corresponding hit, and hotel owners and operators would be well advised to understand their rights and obligations under various agreements in such circumstances.

With respect to management agreements, operators and owners often agree to language obligating the hotel to be operated pursuant to an operator-prepared, owner-approved annual budget. Most sophisticated management agreements will permit variances from such budgets up to a fixed percentage variance, and require that the operator provide updated budgets and seek owner approval for changes to the budget. Those agreements will also often require the owner to contribute capital to the hotel if needed to comply with the budget. If a hotel lacks adequate funds to pay expenses, the hotel may well experience a further drop in performance as expenses, including employee costs and maintenance costs, go unpaid. Thus, an operator and an owner should revisit their management agreements to confirm what steps need to be taken if revenues experience a decline from Covid-19.

Likewise, owners and operators should revisit their loan documents to understand what impact a drop in performance may have on their loans. Most hotel loans will measure performance on a regular, periodic trailing cycle, and contain covenants requiring a minimum debt service coverage ratio, a minimum debt yield, or both, and will require approved budget provisions similar to a management agreement. If hotel performance begins to lag, a hotel loan may require that a cash management regime be implemented, which gives the lender greater control over hotel revenues and expenses pursuant to a lender-approved budget, and reserve any excess cash flow. In addition, many loans may contain a “carry” guaranty feature, whereby a guarantor has agreed to fund all or some portion of debt service, taxes, insurance, and operating expenses if revenues are inadequate. Given these types of loan provisions, owners and operators should consult with their counsel to understand what their rights and obligations are under the pertinent loan documents.

Conclusion

In conclusion, hotel owners and operators stand at the forefront of businesses dealing with the Coronavirus, and need to take adequate steps to understand the risks it poses to their business and assets, not only a medical level, but on an operational and liability level as well. Owners and operators are advised to consult with their counsel about these issues.

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