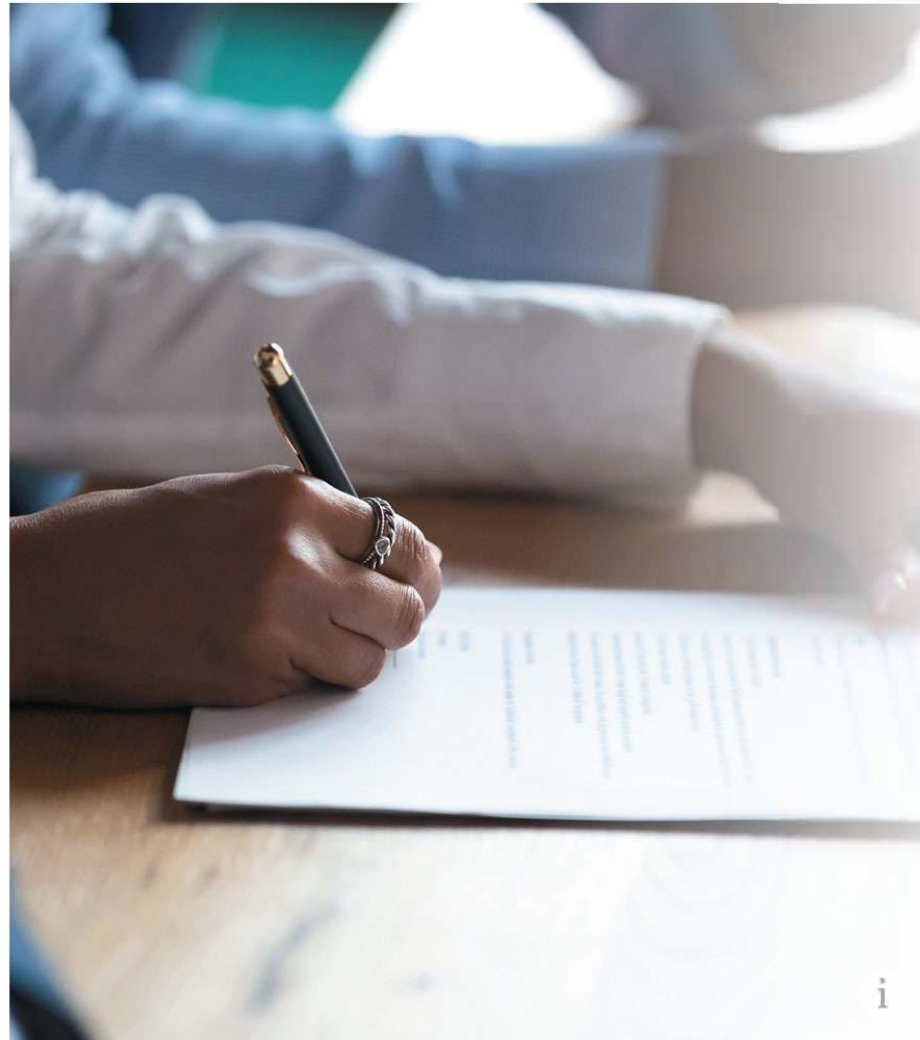


FEATURE

Know before you go

10 tips to successfully negotiate brand contracts

by STEPHANIE STEPHENS



4-MINUTE READING TIME



CHANCES ARE YOU HAVE QUESTIONS ABOUT hotel franchise agreements. As an owner, your bottom line is on the line, and you shoulder the most risk in an agreement with a brand or franchise.

Aim for the most effective contract that achieves your objectives, says Rahul Patel, managing partner of Patel Gaines, Attorneys at Law, which has locations in Texas and a diverse client list comprised of more than 200 hotels. Brands are your "partners," but like you, they're in business to make a profit and to sell. Here's how to hold your ground during the sometimes challenging negotiation process.

1 KNOW YOUR BARGAINING POWER

As a franchisee, you may wonder how much influence you have. "There's always room for a subtle discussion of certain things," Patel says. Larger brands with staying power may be more flexible.

"If you're doing something for the first time, like negotiating an agreement, you may not have great bargaining power," says AAHOA Interim President & CEO Rachel Humphrey, a former franchise attorney. "When you own other properties or have a highly sought-after location, you may have greater bargaining power."

2 GET THE RIGHT KIND OF LEGAL HELP

This is complex stuff, especially to the uninitiated. With so much at stake, don't just hire a general business attorney but someone with deep experience negotiating similar agreements who's also grounded in reality, Patel says.

"Try to find an attorney who's worked with a particular brand and has a proven history and knowledge with your chosen franchise," he says. "You don't want them to go in asking for things that will never happen but for things that can actually be accomplished as changes. At the same time, ensure they know how the agreement truly operates."

3 UNDERSTAND THE "CHICKEN AND EGG" CONUNDRUM

Patel knows owners ask themselves, "Do I pick the land or the brand first?" Imagine you commit to build a Marriott at a specific site. Then, for whatever reason, things don't work out with estimated timelines or permits – a \$10 million project doesn't build as fast as a smaller one. Luckily, there are steps to take and options to consider before making your choice.

Know your market and let the franchisor know you do, Patel says. Early on, contemplate those "what ifs" and bargain for them, especially around factors such as your original construction or opening deadlines, he says.

"If you have to pay for an extension, plan for adequate contingencies in your contract, and remember that on new construction, extensions are very important if things don't go as planned," Patel says.

If you're building, explain project details from the onset during negotiations, along with potential roadblocks, then build those into a sensible timeline, he says.

4 COME TO TERMS WITH YOUR TERMS

A franchisor always has more grounds to terminate a franchise agreement than a franchisee does, Humphrey says. Failure to comply with contractual requirements may result in termination before term's end, which may result in damages.

Maybe your term is from May 1, 2019, to May 1, 2029, and you, like some owners, think the 10-year term just expires. "Every contract is different," Patel says. "You want to dictate the term that includes windows for exiting and to negotiate the ability to exit early. At the same time, on the back end, you don't want to get involuntarily terminated for minor or technical defaults."

Exercise your exit wisely. "It might be a six-month notice, three-month notice, or, unless otherwise cancelled, the contract automatically extends or renews," he says. "Either way, you don't want a letter saying you defaulted or failed to give proper notice."

Maybe you negotiate a 10-year term with a five-year window. "You have to be in good standing before the term," Patel says. Don't get two months behind in franchise fees, and don't default. Also, with so many trigger points, stay current on all franchise agreements, then terminate."

5 KNOW WHEN TO STAY OR GO WHEN NEGOTIATING TERMS

If you're implementing a property improvement plan, know exactly what that renovation entails.

"Potential owners evaluating second- and third-tier brands should ask about property improvements and system fees," Patel says. "Maybe you invest \$500,000 on a 10-year deal, plus you pay 10 percent in combined fees. Will you at least net that? A net of \$900,000 in 10 years isn't enough return on investment, so you may reconsider the deal or the deal terms to get a double-digit return increase on revenue instead."

According to Patel, building a new 10-story luxury hotel is very different from buying a 145-room exterior corridor, 35-year-old conversion property.

"If you haven't thought about what you need, you can't ask for what you want," he says.



6 READ THE FINE PRINT

"While many first-time hoteliers will tell you that, at one time, business was done on a handshake – and that was a bond – now business is done by detailed contracts and it is necessary to study the fine print," Humphrey says.

Heetesh Patel of Neves Investments, LLC, owns hotels in Tennessee, Florida, and Texas, and lived in hotels and motels until he was 18. He urges prospective owners to read every word of the franchise agreement, which can be several hundred pages, and to understand all potential pitfalls and expectations.

He concurs with Rahul Patel that you should seek legal help for any gray areas because the franchisor's initial language likely won't favor you.

"Always consider the franchise fee, cause for termination, and those damages incurred if you exit from an agreement or it's terminated," he says.

7 BE PROACTIVE ABOUT PROTECTIONS

Many franchisors or brands provide an area of protection, but it can vary, Heetesh Patel says. Know whether you have territorial rights and whether you're afforded protections geographically or within the vicinity.

"Most franchisors will not negotiate protected territory with cross-brands," Humphrey says. "Determine what protection you need to thrive, not just survive. Suppose Brand X puts a hotel at the next exit, and that new hotel will directly compete because now you both attract the same guests. This can determine whether you should sign that agreement. A well-thought-out area of protection is one of the most important items on your wish list."

8 THE ECONOMIC CLIMATE SETS THE TONE

"Negotiation often depends upon the motivation of the franchisor," Heetesh Patel says. "A lot of demand for the brand, along with a healthy economy, will most likely mean your opportunity to negotiate will be very little."

A new brand will have more willingness to negotiate those key components, such as the actual royalty rate, the term, and the window during which termination can occur, he says.

9 ASSUME NOTHING

Heetesh Patel tells the saga of a colleague who entered into a franchise agreement for a new build then opted not to build on the original site. The new location was nearby, but the franchise agreement was drawn up for the former address.

"That cost him seven digits in liquid damages," he says, "because it wasn't negotiated beforehand."

10 ASK YOUR AAHOA PEERS FOR ADVICE

It's a small world of connectivity, so our members suggest you ask these or other important questions of other hoteliers about a prospective franchise partner, Humphrey says:

- What do you know now that you wish you knew then?
 - What are some challenges, if any, you're facing with your property?
 - How do you feel about support from the reservations system?
 - How about from the brand support teams?
 - How is your area director?
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- If you have a problem, can you get someone on the phone?

"Our organization is a network of people with tremendous value who will help, and who may have learned very expensive lessons," she says.