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Issues for Hotel Operator Tenants When Negotiating Leases

February 24, 2015 5:31am

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By Jill R. Johnson

February 24, 2105

Hotel operator tenants must be careful when negotiating lease agreements, because property owners and leasing operators have different goals arising out of the relationship. Although every hotel lease agreement is unique, there are certain provisions that hotel operators should be aware of during these negotiations.

This article examines a few of the most problematic lease provisions from a hotel operator's perspective, and offers guidance on how to navigate these potential pitfalls during the negotiation process. We should note, however, that our goal here is to discuss certain situations in which a tenant would be entering into a lease for the construction and/or operation of hotel on a parcel or in commercial premises owned by the landlord. We do not address the nuances of a hotel management agreement between a hotel operator and a hotel owner, where a separate lease agreement may or may not be involved.

Build-Out/Construction Issues

Commercial premises, in general, often take one of two forms: either they are "turn-key," which means that the landlord agrees to provide and perform certain specified work, with anything beyond that work being done at the tenant's expense, or the premises are built out by the tenant, usually with some allowance from the owner.

In situations where the landlord is responsible for the build-out of the space, a hotel operator tenant should try to get the owner to perform as much work as possible, and to provide some type of warranty for the work that is performed. Hotel operator tenants should also be careful when agreeing to any clause providing that the commencement date can be extended without penalty to the landlord for as long as it takes the landlord to complete the build-out of the space. These provisions usually also provide that the tenant's acceptance of possession of the premises is deemed as acceptance of the premises, and operates as a waiver of any claims against the landlord related to construction defects or delays, which is not advisable from the hotel operator's perspective.

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A landlord ordinarily has no duty to repair a commercial premises, absent some statutory or contractual obligation to do so. In fact, if a lease requires the tenant to maintain and repair the premises, without specifying further, but is silent with respect to the landlord's obligations, the tenant may be required to make any and all maintenance and repairs to the premises, both ordinary and extraordinary, including expensive structural repairs.

Typically, the parties in a commercial lease will agree to a repair and maintenance provision that places some obligations on both parties. These provisions usually require the tenant to make or pay for minor repairs and maintenance, or "ordinary" repairs, and require the landlord to make or pay for major capital expenses or "extraordinary" repairs to the property.

A hotel lease agreement is no different. Problems arise when these provisions are not explicitly drafted.

For example, numerous disputes have arisen out of whether the landlord or hotel operator tenant is responsible for certain expensive repairs, such as the repair and replacement of HVAC units, roofs, parking lot repair and maintenance, wiring, elevators, etc. In these situations, the lease provision at issue usually fails to sufficiently define a key term, such as "repair," "maintenance," "structural," "extraordinary," or "ordinary wear and tear." As a result, it is often left to a court to interpret the term - and the parties' intentions - with respect to repair and maintenance obligations. In this situation, both parties run the risk of the court interpreting the provision in a way possibly not intended by either of them.

In the context of repair provisions, this is a situation where it behooves the hotel operator tenant to be as specific as possible. Hotel operators should clearly define and delineate the parties' respective obligations regarding the maintenance and repair of the property, including not only the interior of the property, but any and all buildings, structures and improvements on the property, as well.

Furniture and Equipment

It is also advisable for hotel operators to specify ownership rights to the furniture and equipment in the premises in their hotel lease agreements.

There are two main scenarios: first, the tenant owns the furniture and equipment, meaning the tenant brings the furniture and equipment to the premises, and is solely responsible for its maintenance and replacement.

Alternatively, the tenant could negotiate to receive/use the landlord's furniture and equipment. Under this scenario, when the lease ends, the tenant is typically responsible for returning the furniture and equipment in the same condition (normal wear and tear excepted) to the landlord, and the tenant would be responsible for replacing any damaged items, to the extent replacement is warranted.

If a hotel operator tenant is going to agree to replace landlord-owned furniture and equipment at the end of the lease term, the parties should be very specific regarding the criteria of when replacement will be required. The parties should also be specific regarding what is required in the event certain pieces are unavailable at the time of replacement (because of discontinuation, etc.).

Insurance/Indemnification

Aside from the traditional liability insurance that most hotel operators are familiar with, there are several specialized products that are also worth mentioning.

First is business interruption insurance. This exists to help the hotel return to the financial position it was in prior to whatever catastrophe triggered the loss. With the impact of foreign illness outbreaks (SARS, Ebola, etc.) in recent years and political upheaval around the globe, these policies may be worth the extra cost.

Another relatively new type of coverage is terrorism insurance. Terrorism coverage is often excluded from general liability insurance policies, but the impact of a terrorist event on the hotel industry can be dramatic. Again, this is a product whose need should be evaluated on a case-by-case basis, but it may be worth negotiating for the owner to provide.

In addition, hotel operators are always going to have to deal with issues of assumption of risk related to personal injury or negligence claims from guests. Ideally, hotel operators should include an indemnification provision in their lease agreement that requires the landlord to indemnify them for any such claims except to the extent the injuries resulted from the hotel operator's gross negligence, fraud or willful misconduct.

Conclusion

Although it can be tedious during the negotiation process, it is important for hotel operators to remember that what may seem like "detail overkill" on the front end can become critically important if a problem ever arises under the lease agreement. Being aware of the issues that are associated with these types of provisions will give hotel operators the ability to negotiate the most favorable terms in their lease agreements, which is ultimately the goal.

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About Jill R. Johnson

Jill R. Johnson is a commercial litigator with Chamberlain Hrdlicka (Atlanta), who counsels clients with landlord/tenant and real estate disputes.

Jill may be reached at (404) 588-3574 or by email at jill.johnson@chamberlainlaw.com.

Contact: **Jill R. Johnson**

jill.johnson@chamberlainlaw.com / (404) 588-3574

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