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2009 Current Legal Developments: Issues with Impacts

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Is the Glass Empty Or At Least Half Full?

Times are tough. No doubt about it. RevPar (revenue per available room) is down over 15%, translating to a decrease in net operating income of 2.5 to 3 times that amount. This edition of the CLIA Buyers Guide is intended for the remainder of 2009. Although I predict that our industry will be on the way to recovery by the summer of 2010, 2009 will be a year of navigating choppy and sometimes uncharted waters. Fortunes are made in times of economic turmoil. Stay focused, sharp and open-minded about the opportunities. A few examples:

1. If you have a loan coming due, you may be able to refinance at a substantially lower value. Remember that many debt instruments are selling at 50% to 65% of par. If you can find a lender who will extend a loan for the discounted amount, your existing lender may be willing to take the cash. What are their alternatives? If successful, you will improve your capital structure and likely save your equity in the asset. Note: prepare to present your proposal using professionals who know what to say and how to say it. Although counsel can be instrumental in formulating the strategies, these proposals are often best presented by certain financial consultants who specialize in these negotiations. Moreover, keeping counsel in the background will likely delay legal intervention by the lender, the cost of which may be charged to you.

2. If you have accumulated substantial cash reserves during the recent record years, the next 6 to 18 months will likely present an opportunity to acquire hard assets at very attractive prices. This may be accomplished through the acquisition of debt, or the real property asset through savvy negotiation with a lender after foreclosure or seller's who may be willing to extend financing themselves if they can get out from under guaranty obligations of debt or franchise obligations.

3. Commodity prices and construction labor costs are down as much as 30%. If you were thinking about building, remember that by the time your project is completed, the economy will likely be turned around and you will be well positioned to capitalize.

The worst of times and the best of times... we will survive and how well we thrive will depend on our grit, determination, and commitment to learning new ideas and employing ingenuity.

Where You Form Your Partnership/LLC Really Matters

The 9th Circuit Court of Appeals has determined that a general partner (GP) of a California Limited Partnership (this will also apply to LLC's) must excuse itself from voting its interests (general and limited) on matters of winding up the partnership (e.g., mergers or sales of substantially all of its assets in contemplation of winding up, acts that are properly the subject of partnership vote wherein the GP has a self-interest in the outcome of the matter such as the acquirer having some affiliation with the GP). This is true even if the partnership agreement, by its terms, permits the GP to exercise its right to vote, with full disclosure of the self interest. The Court reasoned that such action by the GP is "manifestly unreasonable," and therefore in violation of Corporate Code Section 16404, and disallowing the propriety of any use of the loophole in Corp. Code § 16403 regarding disclosures. Many partnerships/LLCs will be affected, and the GP who often holds a substantial—if not a majority—interest as a limited partner must consider the implications of this decision and other statutes when considering matters that may constitute self-dealing.

Tip: Carefully drafted partnership agreements and LLC operating agreements of entities formed and operated under Delaware law, even if operating in California, can avoid the restrictions of the recent 9th Circuit decision.

Hotel Owning Landlords: Watch Your Back When Evicting Restaurant and Bar Lessees

A recent California Court decision held a landlord liable for injury to a person on a tenant's leased premises, after a judgment for possession was issued, but before a Sheriff could serve the writ of possession. The Court reasoned that when a tenant defaults in the payment of rent, the landlord should be aware of the possible neglect of the condition of the property. The landlord has a duty to inspect the premises, and is properly put on notice that the physical condition of the premises may not be properly maintained. In the case, the victim was injured inside a nightclub. If you have leased restaurants, lounges, or clubs at your hotel, keep this in mind.

Franchise Disputes: Franchisees Do Have Certain Rights, But You Have to Play Your Cards Carefully

Franchisors are increasingly resorting to arbitration clauses to avoid statutory venue restrictions. Courts are increasingly open to invalidating venue provisions regarding arbitration that require a franchisee to conduct the arbitration outside of California.

Note: even if the case is litigated, not arbitrated, should the franchisor file first in their home state, the likelihood of ever getting the case back to being heard in California will be diminished. Even if successful, the hotelier will incur substantial expense in doing so. If you have cross claims, you may wish to initiate the lawsuit in California before the franchisor can file.

Conclusion

Now, more than ever, employing best business practices in your operations, your acquisition of assets and financial and physical resources, your selection of professional advisors, and your attention to customer needs and opportunities will determine how well you endure and survive the current climate. You can be sure that recovery will happen. It's just a matter of time.

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