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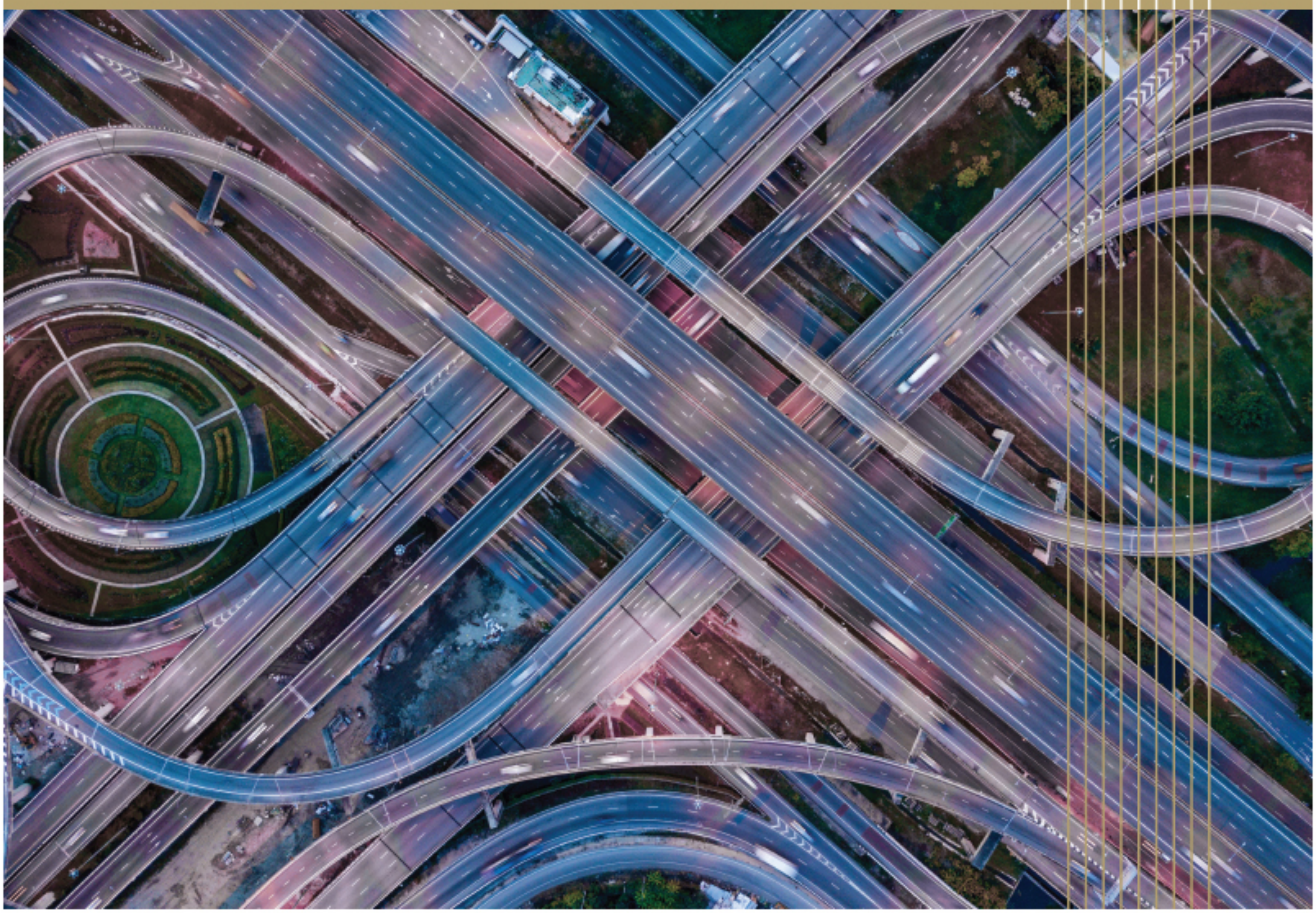
2020 Roadmap for Distressed Hospitality Assets

Navigating COVID-19 and the Aftermath During These Troubled Times



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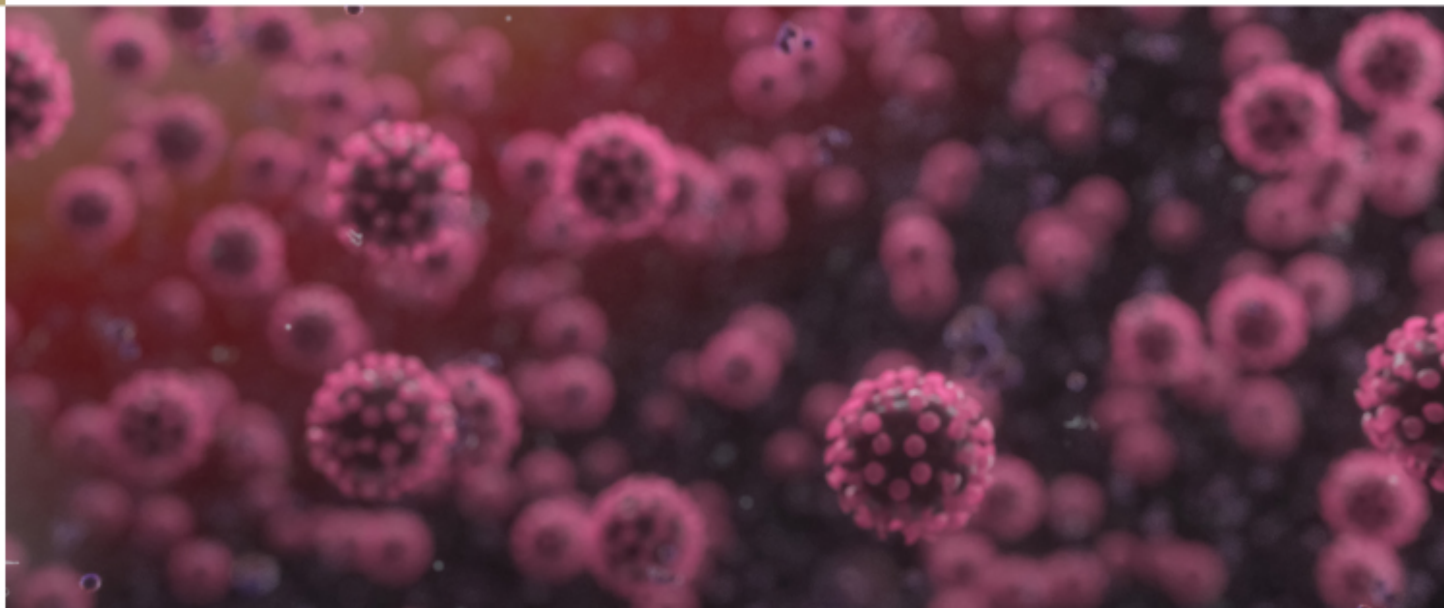

PROLOGUE

The novel coronavirus (COVID-19) could cost the global hospitality industry hundreds of billions of dollars over the coming months. COVID-19 has infected almost four million people worldwide and killed hundreds of thousands in mere months. As of this writing, the United States alone has over a one and a quarter million confirmed cases of COVID-19, the most of any country in the world, and with increased access to testing and reduced social restrictions, the number of new cases and fatalities caused by the virus are expected to remain at extremely high levels.

In recent months, most of the globe has been operating under some form of social distancing, isolation, or quarantine, with travel restrictions imposed on an unprecedented level. National emergencies have been declared and local and state governments issued edicts that have dictated which businesses can operate, what services they can provide, and how many employees they can staff. The effects have been chaotic, and it often feels impossible to stay up-to-date on such an ever-changing situation. As a result, hospitality providers are left confused about what decisions to make, or even which decisions can be made in compliance with shifting laws and regulations.

COVID-19 has already brought dramatic economic disruption, in particular to global supply chains and travel markets. Among other things, this pandemic has meant the cancellation, rescheduling or changing of major events by governments and private businesses across the country and beyond (e.g., Facebook, Google, Microsoft, and China's Communist Party, among countless others, have already cancelled, or changed to "digital first", planned summits and meetings, major league sports seasons have been cancelled or suspended, and the Tokyo Summer Olympics have been postponed for a year) resulting in the closing of hundreds of hotels and thousands of restaurants, the stoppage of hotel and resort construction, the collapse of transactions that were near closing, and a paralyzed travel sector around the world. For both hotel owners and operators, the ongoing pandemic has created massive uncertainty around business operations, with many tossing the word *depression (*not so much *recession)* around with increased regularity.

If you've been in the hospitality business for as long as I have, you remember the battle cry that we lived by during the early nineties: "Stay Alive 'til '95!" And what did we do? Hotel and resort workouts, foreclosures and bankruptcies — over and over and over again — for five long years. And we did it again after 9/11 and through the Great Recession. Remember "Extend and Pretend"? What will this crisis be coined? Whatever it is, we have indeed entered a similar era that I hope is not as long or deep as it was back in those days, but I fear it may be worse. We are all in this together, and we must all represent our varied interests in this industry to the best of our abilities. To that end, we are pleased to present this guidebook on the foreclosure, workout and bankruptcy issues facing our clients and others who are in the hotel and resort sector affected by COVID-19.

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 may or may not follow a similar pattern. Whichever, the hospitality market is in for some trying months.

During these troubled times, however, I believe there are a number of actions you can take to secure the future of your business and your brand. The approach of this text is to adopt the view of an outsider looking in to a troubled hotel or resort asset — perhaps as a professional who has been given the responsibility to first close an asset and thereafter to review the aftermath and give advice to the owner, a third-party capital provider or a purchaser of the asset or the debt that it secures.

With all of this in mind, we begin with a consideration of the issues the owners and operators and capital providers are facing in the closure of hotels and resorts and, in particular, the myriad challenges facing all of the foregoing during a period of mass layoffs and the furlough of employees and unprecedented periods of mass unemployment. We then discuss the beginning of the end of this terrible crisis -- what everyone will do to move toward recovery, with the first step being understanding the hospitality asset itself (i.e., whether it is a limited service, upscale or luxury hotel or whether it has a mixed-use aspect) and a focus on the nature of the asset as an ongoing business in a (hopefully) recovering market but with reluctant patrons, with many moving parts, and with different stakeholders weighing competing interests.

Next we will turn our sights toward the ownership entity. Most hotels today that are not owned by public companies or private REITs are in fact owned by joint venture vehicles, often a special purpose vehicle (with limited liability companies being the most common entity of choice). It is within the JV that a core problem may arise in the face of COVID-19 — a lack of capital caused by debt levels borrowed at the height of the capital markets of this decade, and exacerbated by a reduction of “RevPAR” (revenue per available room) and a reduced occupancy that no one could have predicted and that cannot support the debt source coverage ratio (DSCR) or loan-to-value (LTV) ratio required by lenders.

Speaking of RevPAR and the financial performance of the hotel, it is the management agreement that will often dictate the value of the hospitality asset, so we must spend a few pages discussing the need for greater asset management during distressed times and, ultimately, the potential restructure, if not the termination, of the management agreement (depending, of course, on whether the management agreement was subordinated to the secured debt at the time executed) as a potent tool in the bid and/or LTV of an owner to create value or stave off foreclosure or bankruptcy.

Any discussion of the management of operating businesses would be incomplete without an analysis of labor issues and labor agreements. The area of labor and employment law is a minefield of potential liabilities, many of which fly under the radar of owners and managers. We touch upon the most common areas of concern in labor relations and regulations.

We follow by turning our attention to the potential purchase of the hospitality asset itself and take the reader through a due diligence review of the various, usually hidden, risks that he or she will have to identify and address through the negotiation of a purchase and sale agreement (“PSA”). We discuss how escrowed holdbacks or, better yet, letters of credit, afford far better protection to the purchaser than guarantees and indemnities (which are difficult to enforce and may be worthless when given by parties without meaningful financial strength).

We next discuss the issue du jour: acquiring the distressed debt. Given the complex layered capital structures utilized during this last cycle, potential purchasers will have many more options than in years past. These options, however, come with complications and increased price and risk, so we spend time discussing the diligence needed to decrease the risks to the purchaser.

If you've survived in this industry, you've had to be resourceful and innovative in your approach and strategy — adapting to new market realities and utilizing all the options at your disposal. Our discussion of troubled hospitality assets would not be complete without an in-depth discussion of what happens when you are facing receiverships and foreclosure.

Some lenders (or, for that matter, purchasers) will foreclose or perhaps acquire by deed in lieu assets that are currently under construction. This type of transaction deserves some attention as it presents a host of additional issues that are both complex and fraught with risks and require great care to consummate.

When there is no other alternative, bankruptcy is often the course of choice for the owners of hospitality assets — something that unfortunately will be more and more common with the effects of the outbreak of COVID-19 coming to fruition, no matter how lean owners try to be. The nuances of bankruptcy have changed in a number of very subtle ways since the early nineties and it's crucial to understand the implications to debtors and creditors alike.

By the way, as an alternative to reorganization, a Chapter 11 proceeding also permits the sale of the hospitality asset through a 363 sale procedure. A 363 sale can be a quick and efficient way in which to sell a hotel or resort free and clear of all known and unknown third-party claims and liabilities, but the purchaser must beware of being overbid without adequate protection (largely in the form of a breakup fee) in the event it is not the winning bidder.

Nearly all five-star hotels and resorts (as well as some four-stars) over the last decade were developed in tandem with for-sale real estate (e.g., vertical condominiums and other horizontal villas). This created the need for complex ownership regimes to which all constituents were a party (from both a use and a cost-sharing point of view). Because any workout involving these mixed-use assets will necessarily involve the other users and owners (including office, retail, theater and sports venues), we spend a fair amount of time discussing the most common issues faced when working through a workout, foreclosure or bankruptcy of mixed-use hotel and resort products.

Finally, many hotels and resorts have several liquor licenses and, particularly in Las Vegas and other gaming destinations around the world, at least one gaming license. Without licensure, there is no hotel, resort or casino, and we describe how to continue operation of the food and beverage and gaming operations while licenses are applied for, reviewed and issued, throughout the change-of-ownership period of foreclosures, bankruptcies and/or sales.

In that vein, we believe you will find our *2020 Roadmap for Distressed Hospitality Assets: How to Navigate COVID-19 and the Aftermath in These Troubled Times* insightful and helpful. Please note that federal, state and local laws, regulations and orders are changing not just daily but often hour by hour through this crisis, so nothing in this guidebook should be deemed unequivocal the second after it is published…but we do intend it to be a living, breathing document that you can request and receive updates upon demand. So please stay in touch, stay safe and stay healthy as we navigate these unprecedented times together.

Rick S. Kirkbride, Global Chair: Hospitality & Leisure Practice Group

PAUL HASTINGS GLOBAL HOSPITALITY & LEISURE PRACTICE GROUP

The Paul Hastings Global Hospitality & Leisure (H&L) Practice Group is an active, full-service practice group focusing on the legal and business needs of real estate development companies, institutional lenders, investment banks, capital providers, owners and operators. With more than seventy-five lawyers servicing H&L clients in twenty-two global offices across four continents, the H&L practice encompasses the development, acquisition and sale, finance, leasing, operation, management, licensing, branding, repositioning, roll-up, foreclosure, workout and restructuring of hotels, condo-hotels, resorts, branded condominiums, commercial and residential subdivisions, 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, and other hospitality, recreational and real estate-based entertainment properties and businesses as well as mixed-use developments containing any combination of the foregoing components in North America, Latin America, the Caribbean, Europe, Asia and the Middle East.

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DISCLAIMER:

This 2020 Roadmap for Distressed Hospitality Assets was prepared by members of the Hospitality & Leisure Practice Group at Paul Hastings LLP ("PH"). However, real estate transactions, particularly those pertaining to distressed or troubled assets, present complex issues that are specific to each transaction, asset, period of time, jurisdiction, sequence of events and party involved, among others factors. To that end, the contents hereof do not in any way constitute legal advice and should not be relied upon as such, nor do they purport to comprise a comprehensive list of potential issues or absolute advice as to how to deal with the specific situation presented by an asset or portfolio of assets. Instead, the information contained herein is intended for the sole purpose of assisting readers in identifying a few of the numerous potential issues that could arise in the course of a hotel or resort acquisition, disposition, foreclosure, bankruptcy or other court proceeding and perhaps providing some guidance as to how to get started in your transaction.

PH in no way intends for the contents hereof to be relied upon or viewed by any potential reader as legal or any other type of advice. All readers agree that the information contained herein is provided for informational purposes only. PH strongly urges readers to seek the advice of counsel regarding each reader's specific circumstance and contemplated transaction.

I. FIGHT COVID-19 — THE FRONT LINES

A. FIRST THINGS FIRST. First things first means…can or should you remain open during the COVID-19 crisis. There have been no federal closure orders yet, but there are over three hundred state, city and county orders that must be considered. On a short-term basis, some hospitality businesses will be impacted by "Safer at Home" and other orders requiring non-essential businesses to close during a period of social distancing. These orders vary from state to state, with "essential businesses" being defined differently in each case. One would assume that federal and state laws would be unequivocal as to whether hotels and resorts had the legal right to remain open, but the fact is that federal, state and local laws have been not just inconsistent but also flat out contradictory, and they are changing seemingly daily. A state-by-state guide to the orders made as at the time of publication is attached as Annex A, but any assessment of whether a hospitality business can remain open during the continuation of the COVID-19 outbreak must be updated to the minute and include specific review of relevant local county and city orders as well.

1. Ability to Operate. Once you've determined whether to remain open (or re-open), even with just a skeleton crew, and before we get into the nitty-gritty, take a moment to assess the state of your business. If you're open and operating, remember that your employees are the most integral piece of your day-to-day operations. You can't function without them, and respecting that they're on the front lines of a crisis will go a long way. As noted above, in some states, hotels and places of accommodation are being classified as "essential" services, which means your staff—your kitchen, your cleaners, your reception, your reservations desk—they are all essential to your service. Remember, only essential workers needed for continuity should be permitted to work inside the hotel under most local orders.

   a. HOTEL CLOSURES GENERALLY. Prior to closing your hotel or substantially reducing hotel operations (including large reductions of staff and movement to the use of only a "skeleton" staff), owners should consult any and all applicable key agreements, including, without limitation, the hotel management agreement (the "HMA"), the franchise agreement (the "FA"), loan agreement and related agreements. Often, closure is not specifically addressed or contemplated in these agreements, but in some cases, consent of a counter-party may be required. Additionally, if you are considering closure or substantially reducing hotel operations, please refer to the checklist attached as Annex B (provided as a courtesy of HotelAVE) of certain steps to take and considerations to keep in mind when doing so.

b. REVIEWING THE HOTEL MANAGEMENT AGREEMENT. Unlike certain other key parties (e.g., your franchisor or your lender), the management company will have to be included in any decision to close the Hotel, as their cooperation will be required in any suspension or reduction of hotel operations (including, without limitation, as it relates to the employees, as such employees, more likely than not, will be the employees of your management company). In reviewing any applicable HMA prior to closing your hotel, consider the following questions: (i) will a closure or partial closure (or substantial reduction in operations) constitute a default under the HMA; (ii) are there any applicable force majeure or “material adverse effect” provisions that operate to excuse owner’s performance (and, if so, are there applicable notice requirements necessary to invoke such protections); (iii) what are owner’s obligations to fund operating expenses during any period of closure; (iv) what is the management company’s right to request working capital during any period of closure (and what are the management company’s remedies in the event of any failure to fund the requested working capital); (v) what are owner’s obligations to fund management fees and centralized services fees during any period of closure (and will the payment of any business interruption proceeds be included in any such calculation); (vi) if there is ongoing construction, will any applicable regulation result in delays or missed deadlines set out in the management agreement (if so, look again to see if any force majeure or “material adverse effect” provisions can operate to excuse such delays); (vii) are any of Manager’s obligations guaranteed by an upper-tier entity; (viii) does the existence of a force majeure result in a waiver or equitable adjustment of any applicable performance test, performance guaranty or other performance-driven tests or terminations set forth in the HMA; and (ix) is there any flexibility in how funds in any FF&E Reserve can be used? These considerations will grant you a well-rounded view of how to mitigate your risks and liabilities under your management agreement, preserve and enforce any rights you may have under your management agreement and negotiate any waivers or amendments to the management agreement which, in all such cases, may be appropriate during these uncertain times.

Once you’ve done your homework, it’s time that you had a discussion with your manager: (1) how will working capital needs of the hotel be met during the closure (i.e., some additional deposit from owner); (2) can a consensus be met on changes to the applicable annual budget; (3) can there be a waiver of base, incentive, marketing, sales and/or centralized fees; (4) can there be a waiver of the requisite FF&E reserves and/or any capital expenditures; (5) will the costs of closure be considered an operating expense; and (6) which legal standard shall Manager be required to use (i.e., commercially reasonable efforts) to comply with its obligations under the management agreement.

c. REVIEWING THE FRANCHISE AGREEMENT. In reviewing your FA prior to any hotel closure, similar to the exercise done in connection with the review of the HMA, consider the following questions related thereto: (i) will a closure or partial closure or failure to operate continuously constitute a breach or default under the FA; (ii) would continuing operation of the Hotel in light of health concerns constitute a default by franchisee (or otherwise allow franchisor to terminate the FA); (iii) are there any applicable force majeure or “material adverse effect” provisions that operate to excuse owner’s performance (and, if so, are there applicable notice requirements necessary to invoke such protections); (iv) What are franchisee’s obligations to fund license or royalty fees and centralized services fees during any period of closure (and will the payment of any business interruption proceeds be included in any such calculation); (v) if there is ongoing construction, will any applicable regulation result in delays or missed deadlines set out in the FA (if so, look again to see if any force majeure or “material adverse effect” provisions can operate to excuse such delays); (vi) is there an FF&E Reserve contribution requirement and, if so, is there any flexibility in how funds in any FF&E Reserve can be used; (vii) is there a guaranty by a parent affiliate which backstops franchisee’s obligations if franchisee fails to perform; and (viii) is any applicable franchise guaranty in compliance with any net worth and liquidity covenants. These considerations will grant you a well-rounded view of how to mitigate your risks and liabilities under your FA, and, if appropriate, negotiate any waivers or amendments to your FA which may be appropriate during these uncertain times.

And, like management agreements, it's time you had a conversation with your franchise company: (1) can there be a waiver of any franchise, royalty, license or marketing fees that would be incurred or are payable during closure; (2) can there be a waiver of owner funding of any FF&E and/or capital expenditures; (3) how will the parties determine the re-opening date; and (4) will there be any additional required insurance (and, if so, who will be financially responsible)?

d. REVIEWING THE LOAN DOCUMENTS. The loan agreement is another key agreement that must be reviewed prior to and in connection with any proposed hotel closure to ensure, among other things, that all necessary lender consents are obtained and you are aware of any liabilities or recourse that could be triggered. In connection with such review, consider the following: (i) is lender consent required to close or partially close the hotel or are there any applicable covenants which require you to continuously operate the hotel; (ii) how will a closure or partial closure affect the ability to satisfy debt service or any debt service coverage ratios; (iii) will closure trigger any recourse liability; (iv) are there applicable prohibitions on cash distributions to the borrower; and (v) will distribution of cash to an upper-tier entity in lieu of payment of debt service or other operating expenses trigger liability under the applicable non-recourse guarantees (and are there prohibitions on same)?

These questions and considerations should be taken into account in connection with any determination to close (or partially close the hotel) and tee up conversations to be had with the lender including those involving: (1) the possible suspension of principal payments and the accrual of interest; (2) the negotiation of any forbearance on existing events of default and future events of default relating to COVID-19; (3) the suspension of any FF&E reserve funding obligations; (4) the potential use of FF&E reserves to fund operating expenses to the extent there is insufficient operating cash to do so; (5) the use of any other reserves (i.e., excess cash flow) to fund operating expenses and assuring the capability to use such reserves for specific items despite any event of default; (6) the potential to amend management and/or FAs without lender consent; (7) seeking an acknowledgment that owner can close the hotel without an event of default if required by law or the owner's prudent judgment; and (8) address any net worth or liquidity tests applicable to guarantors.

e. ADDITIONAL KEY DOCUMENT REVIEWS AND CONSIDERATIONS. In addition to the documents mentioned above, also consider the review of the following documents: (i) For buyers and sellers of distressed hospitality assets, it is also important to review your purchase and sale agreements for applicable closing conditions, deposit reimbursement and forfeiture provisions, covenants to operate in the "ordinary course of business", the effect of any "time of the essence" clauses and force majeure provisions and possible frustration of purpose/impossibility defenses to performance; and (ii) For owners, any other material documents which may encumber the hotel or property (or relate to the operation thereof), including, without limitation, ground leases (e.g., does a hotel closure require ground lessor consent or does the failure to continue to operate a hotel on the land constitute a default of the ground lease?), condominium agreements, CC&Rs and rental management agreements, in each case, to assess the need for any additional consents or the existence of any breaches.

f. SECURING THE PROPERTY. Lastly, if you decide to close the Hotel, you should ensure that the hotel is properly secured to ensure continuity of insurance coverage and/or avoid claims of waste or gross negligence.

2. Paid Leave. Assuming for now that you are not closing (as issues involving federal and state WARN Act laws will be addressed below), but nevertheless you have employees that are diagnosed with COVID-19 or otherwise are required or feel the need to quarantine, federal legislation impacting leaves, paid leaves, and sick time (or time off to care for loved ones) is expected to change over the coming months. On March 18, 2020, the President signed the first of these new laws called the Families First Coronavirus Response Act, Public Law No. 116-7 ("FFCRA"), which applies to employers with 500 or fewer employees. The FFCRA law provides that between April 1, 2020 and December 31, 2020, a covered employer must provide:

    a. Two weeks (up to eighty hours) of paid sick leave at the employee's regular rate of pay where the employee is unable to work because the employee is quarantined (pursuant to federal, state, or local government order or advice of a health care provider), and/or experiencing COVID-19 symptoms and seeking a medical diagnosis; or

    b. Two weeks (up to eighty hours) of paid sick leave at two-thirds the employee's regular rate of pay when the employee is unable to work because of a bona fide need to care for an individual subject to quarantine (pursuant to federal, state, or local government order or advice of a health care provider), or to care for a child (under eighteen years of age) whose school or child care provider is closed or unavailable for reasons related to COVID-19, and/or the employee is experiencing a substantially similar condition as specified by the Secretary of Health and Human Services, in consultation with the Secretaries of the Treasury and Labor; and

    c. Up to an additional ten weeks of paid expanded family and medical leave at two-thirds the employee's regular rate of pay where an employee, who has been employed for at least thirty calendar days, is unable to work due to a bona fide need for leave to care for a child whose school or child care provider is closed or unavailable for reasons related to COVID-19.

3. Quarantine. 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 is appropriate. 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 during any quarantine. Depending on the level of the injury, employees also may be eligible for short-term disability benefits.

4. FMLA.[1]

    a. Employee-Required Leave. If you have fifty or more employees, and further assuming an employee meets the FMLA threshold, an employee may take up to twelve weeks of *unpaid* protected leave required by his or her care provider for their own "serious health condition." Employers do not have a legal obligation to grant *paid* FMLA leave to employees, unless it is required under the employer's policies, the specific jurisdiction's laws, or any collective bargaining agreement with a labor union. Generally, while the specifics may vary from state to state, companies' specific policies, employees may use sick days, medical leave, or other PTO options for COVID-19. An employer may require the employee to produce a "clean bill of

[1] Employees not eligible for FMLA leave, or who have exhausted FMLA leave, may be eligible for time off under other applicable leave or sick leave laws issued by states and, at times, local governments.

health" before an employee returns to the workplace, so long as the employer uniformly applies its policy of requiring a fitness-for-duty certification upon return from leave.

b. <u>FMLA: Caring for Family Member with COVID-19</u>. Currently, time off for an employee to care for a family member with COVID-19 should be treated like any other family care leave consistent with federal, state and/or local leave laws and company policy, if any. Employers do not have a legal obligation to grant *paid* leave to employees for family care leave, unless it is required under the employer's policies, the specific jurisdiction's laws, or any collective bargaining agreement with a labor union. However, it is recommended that employers review matters on a case-by-case basis, taking into account the relevant circumstances.

c. <u>FMLA: The Families First Coronavirus Response Act ("FFCRA") FMLA Expansion</u>. For employers with fewer than five hundred employees, the FFCRA adds language to the FMLA to provide a leave and job protections for an employee who is "unable to work (or telework)" because of the need to care for the employee's child (under the age of eighteen) *if the child's school or daycare has been closed* or *the child's care provider is unavailable to do so due to a public health emergency*. It covers individuals employed by a covered employer for at least thirty days. The initial ten days is unpaid (unless the employee elects to use FFCRA Sick Leave pay, accrued vacation, sick time, or paid time off). After the first 10 days, covered employers must pay no less than two-thirds of the employee's regular rate of pay (which includes all salary, hourly pay, and other non-discretionary compensation) for the number of hours the employee would typically work during the leave period, capped at *$200 per day or $10,000 total.* Covered employees who take such a leave are entitled to return to the same or a reasonably equivalent position, under most circumstances. Reinstatement rights for employees of employers with fewer than twenty-fiu employees are subject to additional conditions.

5. <u>PTO & Unemployment</u>. Some states, including New York and California, have modified (or are considering modifying) their Unemployment Insurance eligibility requirements for persons impacted by COVID-19. The Federal Government has taken action, too.

a. As part of the FFCRA, Congress passed the Emergency Unemployment Insurance Stabilization and Access Act ("Emergency UI Act"), which provides $1 billion in emergency administration grants in 2020 to eligible states to help process and pay unemployment insurance ("UI") benefits. The Emergency UI Act also provides temporary federal flexibility regarding those UI restrictions, which are also in federal law. If a state modifies its UI laws with respect to: (i) work search; (ii) waiting week; (iii) good cause; or (iv) employer experience rating, on an emergency temporary basis as needed to respond to the spread of COVID-19, such modifications shall be disregarded for the purposes of applying section 303 of the Social Security Act and section 3304 of the Internal Revenue Code of 1986 to such state law. The Emergency UI Act also provides states with: (1) access to interest-free loans to help pay regular UI benefits through December 31, 2020, if needed; (2) technical assistance from the Secretary of Labor to states that want to set up work-sharing programs (which allow employers to reduce hours instead of laying off employees, and then employees receive partial UI benefits to offset the wage loss); and (3) for states that are eligible for the second half of funding (i.e., an increase of 10% or more in their unemployment rate over the previous year), 100% federal funding for Extended Benefits (which are triggered when unemployment is high in a state and provide up to an additional twenty-six weeks after regular UI benefits (usually twenty-six weeks) are exhausted), which normally require 50% of funding to come from states.

b. The federal Coronavirus Air, Relief, and Economic Security Act (CARES Act), signed by the President on March 27, 2020, includes incentives that encourage businesses to retain employees during this period. For example, Title I of the CARES Act modifies the Small

Business Act, 15 U.S.C. § 656, to allow for widespread and readily available lending to small businesses in the wake of the COVID-19 crisis. Under Title I (denominated as the "Keeping American Workers Paid and Employed Act"), a qualifying business that has suffered a significant disruption due to COVID-19 may apply for a small business loan intended to address cash-flow shortfalls resulting from the crisis (each, a "Small Business Interruption Loan"). The CARES Act appropriates $349 billion toward Small Business Interruption Loans, with the stated intent of providing support for the continuation of business payrolls. Eligibility under the Act will be discussed later in this publication.

B. WAGES AND HOURS. Non-exempt employees need 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. The Department of Labor highlights issues because of COVID-19 in a recent FAQ that can be accessed here: https://www.dol.gov/agencies/whd/flsa/pandemic.

C. 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 has provided health travel notices recommending that travelers avoid "all non-essential travel."

D. WARN NOTIFICATION. In the event you determine it is appropriate to reduce headcount, reduce hours, reduce pay, or shut down operations (collectively, "Work Reductions"), even if temporary, it is critical you consider the implication of the federal WARN Act, state-specific mini-WARN Acts, and the CARES Act. The following twenty-three states have mini-WARN or similar legislation requiring notice: Alabama, California, Connecticut, Delaware, Georgia, Hawaii, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Tennessee, Washington, and Wisconsin. As of March 2020, at least two of the above-mentioned states have provided for shorter advance notice in certain circumstances under its WARN Act in response to the COVID-19 required reductions in workforce. California Governor Newsom signed Executive Order N-31-20 implementing temporary modifications for workforce reductions and New Jersey has recently followed suit with its NJ WARN Act. Keep an eye on this as the situation develops.

Although we attempt to simplify WARN 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.

1. Does Not Apply. The threshold question is whether the WARN Act applies to your workforce. Generally, only employers that have one hundred or more full-time employees (or the equivalent) are covered by federal WARN (fewer total employees, such as only fifty employees in New York, may cause application of a mini-WARN statute). A full-time employee is someone who works more than twenty hours per week and has been employed for six out of the last twelve months. Moreover, if an owner or operator owns or operates multiple hotels or other businesses, it should be considered whether these workforces would be aggregated.

2. "Employment Loss". "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 (generally using a ninety-day look back period and a ninety-day forward-looking window to aggregate impacted employees) include:

a. A mass layoff (employment losses for at least full-time fifty employees constituting at least 33% of the workforce or five hundred full-time employees, regardless of the percentage, at the site); or

b. A plant closing affecting fifty or more full-time employees (e.g., the closure of a restaurant within a hotel).

Note that termination of employees will also impact the eligibility of a business for a loan under the CARES Act and forgiveness of any such loan, as discussed below, as well as the ability to apply for various tax benefits under the Act.

3. Heads Up. Employees must generally be given sixty or more days' notice (depending on applicable state mini-WARN statutes). Given that no one knows the duration of the impact of 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 day of defective notice, again subject to many technical rules.

4. Department of Labor. 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 these exceptions do not excuse giving notice; rather, they waive or modify the 60 days' advance notice requirement.

   a. 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 sixty-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 COVID-19-related layoffs, hotels should expect 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 (for example, Connecticut, Hawaii, Massachusetts and Tennessee) and therefore cannot be relied on to provide a complete defense to WARN Act requirements.

   b. The Federal WARN Act also has exceptions for businesses actively seeking business or capital and encounter 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.

   c. Each of the twenty-three states with a mini WARN Act or similar statute have different exceptions to the advance-notice requirement; however, even if the normal statutory notice is excused because of an applicable exception, notice must still be given. For example, California Executive Order N-31-20, referenced above, suspends the California WARN Act sixty-day notice requirement for those employers that satisfy the Order's specific conditions (permitting them to provide shortened notice). The suspension is intended to permit employers to act quickly in order to mitigate or prevent the spread of COVID-19. However, this Executive Order does not suspend the California WARN Act in its entirety, nor does it suspend the law for all covered employers.

5. 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 not fall below those thresholds.

E. IMPACT UNDER THE CARES ACT. Under the CARES Act, eligibility for businesses to take advantage of various loan entitlements may be limited in circumstances where a business opts to lay off employees. Title I of that Act is denominated as the "Keeping American Workers Paid and Employed Act." Under Title I, any eligible business (under regulations promulgated by the Small Business Administration) operating in the United States with not more than five hundred employees (i.e., total headcount of full and part-time employees (not a full-time equivalent calculation)) will be eligible to receive a Small Business Interruption Loan. Following passage of the CARES Act, statutory eligibility for the loan programs has been substantially limited by subsequent SBA and Treasury guidance and interim final rules. In applying for a loan, the applicant must certify that the current pandemics makes the loan an 'economic necessity', but in doing so must take into account available reserves and other sources of liquidity that could be used to continue operations without "significant detriment" to the business. Under the SBA interpretation, public companies with access to the securities markets would likely not be able to make that certification. Companies with access to other sources of liquidity would be similarly unable make required certifications. Moreover, while the statute waived affiliation rules for those businesses in NAISC Code 72, in order to make funding under the program more widely available, SBA and Treasury have limited the amount available to any one corporate group to no more than $20MM in total. SBA has also indicated that all loans more than $2MM will be audited for eligibility and qualification. The effect of the guidance and regulations has been to limit the availability and utility of the PPP loan for hospitality sector businesses. A centerpiece of this Small Business Interruption Loan program is the potential availability of loan forgiveness for the entire principal amount of the loan. However, such forgiveness is (i) conditioned upon the use of loan proceeds for certain eligible costs and (ii) subject to reduction based upon reductions in payroll and salary. Regardless of the use of the loan proceeds, a borrower seeking loan forgiveness cannot use more than 25% of the loan for non-payroll expenses and must use 75% of the loan proceeds for salaries, wages and benefits during the eight-week period following the date of the loan. The portion of the principal amount of the loan eligible for forgiveness will be reduced based on the ratio of (1) the average number of full-time equivalent employees employed during the eight-week period following loan funding, to (2) the average number of full-time equivalent employees employed prior to the COVID-19 crisis (calculated, at the borrower's election, as the average number of employees either during the period from February 15, 2019 to June 30, 2019, or the period from January 1, 2020 to February 29, 2020). In addition, the portion of the principal amount of the loan eligible for forgiveness will be subject to reduction by an amount equal to the sum of all reductions of more than 25% in salaries and wages for employees as effective during the eight-week period following the loan funding (with reductions to be calculated on an employee-by-employee basis with reference to the most recent full quarter of employment for the given employee, and calculated without reference to employees paid at a rate of more than $100,000 per year during 2019 (calculated on an annualized basis for any pay period during 2019)). These reductions are, however, subject to a savings clause that would still allow forgiveness if workforce and salary reductions are eliminated by June 30, 2020. Consequently, any decision to reduce headcount during the COVID-19 outbreak must be weighed against business needs and eligibility for loan assistance under the CARES Act. Legal counsel should be obtained for specific advice related to any such decision. See the later discussion with respect to Small Business Interruption Loans.

F. 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 death or serious physical harm to … employees." Employers should review their health and safety policies and procedures, as well as Federal and State guidance, in order to identify and evaluate the risks of exposure to employees. After holistically evaluating the risks and hazards, employers should take reasonable steps in accordance with applicable guidance, including with respect to the consideration of steps to eliminate the hazard (e.g., adoption of screening protocols), engineering controls (e.g., installation of physical barriers, increasing ventilation rates, recalibrating HVAC systems), administrative controls (e.g., minimizing close contact among employees, staggered or alternating shifts, discontinuing non-essential travel, revised cleaning and room turnover protocols), safe work practices (e.g., hygiene, training), and the use of face coverings and 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. Recent enforcement guidance from federal OSHA suggests that taking protective measures in accordance with CDC guidance may obviate General Duty Clause violations. There may also be a recording obligation on your OSHA 300 log. Some states have also enacted guidance to address safety concerns surrounding COVID-19.

1. 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.

2. 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).

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

4. The EEOC has issued 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.

G. ANTI-RETALIATION. 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. How an employer may respond to such refusal will require a fact-intensive analysis. It is critical that employers review anti-retaliation policies under OSHA and state laws prior to taking action in response.

H. GUESTS. We understand it can be particularly challenging to consider what to do with guests with COVID-19 symptoms or who are subsequently confirmed as having COVID-19. 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 guest's 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 and engaging in self-isolation in accordance with CDC and other applicable governmental and administrative guidance.

1. Vacating. 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:

a. 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.

b. 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 within about six feet (approximately two 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.*

c. Proactively develop a removal process for infected guests by working with an area medical facility and your local public health official to ensure that infected guests and any exposed employees are receiving appropriate treatment.

d. Develop a process for cleaning and disinfecting the room of an infected guest in accordance with applicable guidance.

I. <u>THE EXPERTS</u>. Make a point of checking with the experts on state of affairs so that you can prepare yourself, your employees and your business for whatever comes next. 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.

J. <u>TAKE ACTION</u>. During this time, you will need to implement measures in your hospitality business that protect everyone on the premises. Be transparent with your staff 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 hospitality business is 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.).

K. <u>EDUCATE</u>. 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.

L. <u>OFFER HELP</u>. For many distressed hospitality providers, the virus has created a gray area regarding workplace issues like employment, health, safety, and privacy. Consider making a statement addressing how you intend to assess the risks to your employees 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.

M. DON'T FORGET:

1. Testing. The ADA prohibits employee disability-related inquiries or medical examinations unless they are job-related and consistent with business necessity. ***Currently,*** with the recent declaration of a COVID-19 pandemic, employers may:

   a. take the temperature of employees coming into the workplace;

   b. ask all employees who are physically entering the workplace if they have COVID-19, if they have symptoms associated with COVID-19 (for example, cough, sore throat, fever, chills, or shortness of breath), or if they have been tested for COVID-19;[2]

   c. exclude from the workplace employees who have COVID-19 or associated symptoms because their presence would pose a direct threat to health or safety; and

   d. bar an employee from being physically present in the workplace if the employee refuses to permit the employer to take his or her temperature or to answer these questions.[3]

2. Compliance. 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.

3. Compassion. 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.

4. Voluntary Disclosure. Because the ADA allows for *voluntary* disclosure of an employee's medical information, an employer could circulate safety information and recommendations about COVID-19 and provide a confidential resource for employees to contact if they wish to disclose personal health information. Any medical information provided by the employee must be kept confidential.

5. The Fine Print. 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); *United States v. Morvant*, 898 F. Supp. 1157, 1166-67 (E.D. La. 1995). That does not mean that greater or lesser steps are never

[2] Employers generally are not permitted to ask the same questions of employees who are teleworking, as they do not pose the same direct threat.

[3] The EEOC advises that to gain an employee's cooperation, employers may consider providing additional information or reassurance that it is taking these steps to ensure the safety of everyone in the workplace.

appropriate; however, employers should be careful to base their alternative decisions on a sound legal foundation.

6. OSHA. 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 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. Relatedly, the below discusses the employer’s ability to limit employee’s OSHA-claim-related remedies.

   a) Can an employer require an employee to prospectively waive rights to assert a workers’ compensation claim?

      i. In many (if not all) states, no. There are explicit laws in several states, including Arkansas, California, New York, Nevada and Pennsylvania, rendering void any agreement by an employee to waive liability under the applicable workers’ compensation code. Even if the agreement was enforceable with no such state law invalidating it, the agreement may not be very effective due to a public policy interest in many states. For example, in California, releases seeking to waive negligence per se are invalid as a matter of public policy. *Capri v. LA. Fitness*, 136 Cal.App.4th 1078, 1087 (2005); Cal. Civ. Code § 1668 (“All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.”). Thus, the release would be invalid to the extent an employee predicates a negligence per se claim against the hotel on violation of OSHA (which as mentioned, among other requirements, mandates that employers provide a safe and healthful workplaces).

   b) **Can an employer limit liability for workplace injuries by asking employees to sign written waivers of claims against third-parties?** In essence, this waiver would limit the hotel employee to receiving only benefits under workers compensation by prohibiting the employee from suing third parties – such as the customers of the hotel or the entity that owns the real estate where the work is performed.

      i. Possibly, depending on the state; litigation precedent varies state to state. For example, the Pennsylvania Supreme Court upheld an agreement limiting an employee’s rights to assert claims against the employer’s customer; however, the New Jersey Superior Court Appellate Division ruled a contract provision unenforceable that limited an employee's right to sue third parties for negligence.

      ii. Even if such an agreement was permitted, its effectiveness in the context of real estate owners as the employer is in question. For example, in California, workers’ compensation law generally does not preempt employee civil damages remedies against nonemployee third parties whose tortious misconduct “proximately” contributed to the injury. Further, there are seemingly limited circumstances under which a real estate owner would proximately cause a hotel employee to contract COVID-19 (though, perhaps, it would protect hotel guests who negligently exposed hotel workers).

   c) Possible legal risks for implementing liability waivers?

      i. In California – and possibly other states – an employee could have a cause of action for wrongful termination if they are fired for refusing to execute a liability waiver that violates public policy. In addition, an employer may be subject to penalties for requiring employees to sign a writing prohibited by law.

7. Service Contracts. Hospitality providers should review their existing service agreements, cancel and negotiate all recurring service agreements where necessary, and lean on their vendors, who will be motivated to work with the providers so that they can retain their business when the market returns to normal.

8. International Considerations. Hospitality providers with international operations will need to familiarize themselves with the COVID-19-related laws, rules and regulations, and orders of the various jurisdictions in which they operate. Governments of numerous countries, including South Korea (see the "Guidelines on Measures in the Workplace to Prevent the Spread of Novel Coronavirus" published by the Ministry of Employment and Labor), and the United Kingdom (see https://www.acas.org.uk/coronavirus; https://www.gov.uk/government/publications/guidance-to-employers-and-businesses-about-covid-19; and, https://www.gov.uk/foreign-travel-advice) have produced guidelines for employers in addressing COVID-19-related concerns.

9. General Steps. Generally, a global strategy for addressing COVID-19-related issues should incorporate the following principles and goals:

   a. Ensure your COVID-19 preparedness task force spans the global footprint of your business and draws together the relevant stakeholders and specialists for a coordinated and coherent global response;

   b. Introduce and update policies and procedures for the workforce so they are clear on their employer's approach to the key issues, such as travel, interactions, reporting of health concerns, attendance at the workplace and pay. Be cognizant of the fact that these may need to change as the local position changes;

   c. Carry out and document risk assessments for those that are vulnerable or high-risk and implement the appropriate arrangements to comply with health and safety obligations;

   d. Revisit and TEST your emergency response plan on a jurisdiction-by-jurisdiction basis, so the local management is clear on the immediate action items, contact details and appropriate global response as matters develop in the relevant time zone;

   e. Devise and circulate a response protocol and a communications pack to ensure consistent messaging across your workforce that can be adapted to local developments;

   f. Ensure that the members of your COVID-19 preparedness taskforce monitor and provide timely updates on the latest guidance and local developments in the relevant jurisdictions, including travel restrictions;

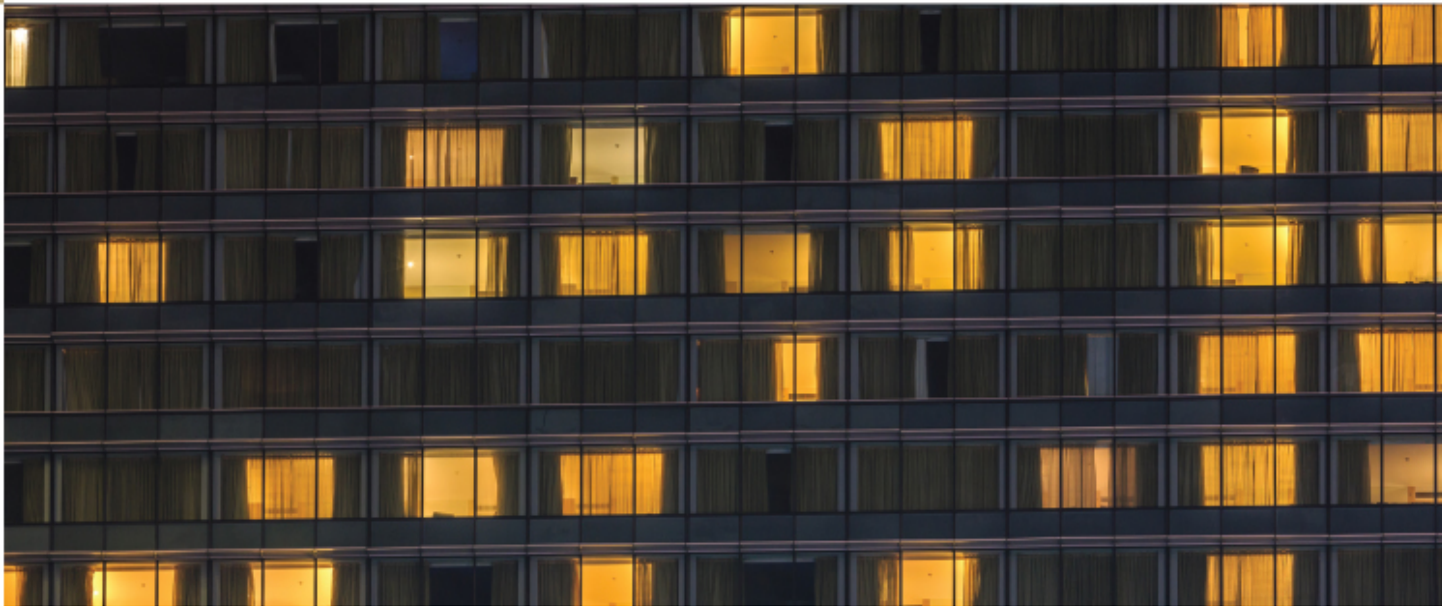
   g. Take the obvious steps to assist in containing the spread of COVID-19 which will vary by jurisdiction;

   h. Leverage local resources (HR, in-house lawyers, and externals) to understand your obligations to inform and consult with the workforce, any works council, or labor union, or notify any relevant governmental authority or ministry of labor in relation to proposed actions by the employer. Feed these back to the taskforce;

   i. Also, ascertain the statutory and contractual rights and restrictions for the workforce, in particular in relation to sick pay, paid leave of absences, health and safety obligations, ability to require employees to work from home, and privacy considerations relevant to your workforce in each jurisdiction; and

j. Charge your finance function to determine if your business is eligible for any of the emergency measures being implemented by governments to offset some of the financial impact of the pandemic.

k. Consider implementing use of the Employee Screening Form included in Annex C.



II. UNDERSTANDING THE HOSPITALITY ASSET: IS IT A BUSINESS OR IS IT REAL ESTATE?

A. INN TROUBLE. A hospitality asset is troubled or distressed when operating revenues decline to the point where those revenues are insufficient (or are anticipated to be insufficient) to cover debt service and/or operating expenses or otherwise to satisfy financial covenants in the loan documents or it's applicable HMA (e.g., debt-service coverage ratios, loan-to-value tests, reserve requirements, or capital repair/replacement requirements to meet brand standards). This may be the case where occupancy rates are low as a consequence of COVID-19 and debt service payments (and other ownership and operating expenses) are difficult to cover. The CARES Act has been enacted specifically to support businesses during this time.

1. Loan Availability. 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, or apply for a Government loan under the CARES Act.

   a. Forbearance. While balance sheet lenders will often decide to grant forbearance based on past relationships, that will likely 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 sixty-day period after a default before the loan is transferred to special servicing (that being said, there is a fair amount of discussion today that suggests, perhaps, if the borrower's request is limited and reasonable, some master servicers might be willing to accommodate the borrower's request without having to send the loan to the special servicers). The borrower could request an earlier transfer (i.e., earlier than 60 days), 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 becomes, the more likely the special servicer is to take action. If a situation is not dire, 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, as discussed above, 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 the HMA or FA. 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 carve-out guaranties require guarantors to backstop real estate taxes and insurance premiums (subject, in some cases, to certain limitations). Other concerns to review in connection with any non-recourse carve-out guaranties 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 repayment of unamortized key money (in the event the HMA or FA is terminated).

b. Loans Under the CARES Act. As mentioned above, Title I of the CARES Act modifies the Small Business Act, 15 U.S.C. § 656, to allow for lending to small businesses in the wake of the COVID-19 crisis. Under Title I (denominated as the "Keeping American Workers Paid and Employed Act"), a qualifying business that has suffered a significant disruption due to COVID-19 may apply for a small business loan intended to address cash-flow shortfalls resulting from the crisis (each, a "Small Business Interruption Loan"). The original CARES Act appropriated $349 billion toward Small Business Interruption Loans, with the stated intent of providing support for the continuation of business payrolls. Since then, Congress appropriated another $250 billion for loan funding purposes, and set aside an additional $60 billion for small lenders and community development lenders.

(i) Eligibility. Subject to notable exceptions discussed below, virtually any business operating in the United States with not more than five hundred employees will be eligible to receive a Small Business Interruption Loan. The statutory eligibility has been substantially limited by subsequent SBA and Treasury guidance and interim final rules. In applying for a loan, the applicant must certify that the current pandemic makes the loan an 'economic necessity'. Under the SBA interpretation, public companies with access to the securities markets would likely not be able to make that certification. Companies with access to other sources of liquidity would be similarly unable to certify. Moreover, while the statute waived affiliation rules for those businesses in NAISC Code 72, to make funding under the program more widely available, SBA and Treasury have limited the amount available to any one corporate group to no more than $20MM in total. SBA has also indicated that all loans more than $2MM will be audited for eligibility and qualification. For distressed properties, the SBA has announced that entities which are in bankruptcy at the time of application, or enter bankruptcy between application and disbursement are not qualified to obtain PPP loans. This guidance has been challenged in several pending actions, but there has not yet been a final determination and the rulings on temporary restraining orders have been mixed. Additionally, this guidance would also suggest that businesses which are in default of covenants under existing debt could also be found not to be eligible for PPP loans. For purposes of determining an applicant's number of employees, all employees of a given applicant and its affiliates, as broadly defined, are aggregated (subject to the waiver of affiliation for the hospitality and food services industries as discussed below). Under the Small Business Act as in place prior to the CARES Act, the aggregation of employees and annual receipts among affiliates would often preclude many businesses from qualifying for small business loans. Of great significance for the hospitality industry, the CARES Act contains a waiver of the affiliation provisions of the Small Business Act, with the waiver being expressly applicable and limited to business concerns having a NAICS code 72 ("accommodation and food services"). This waiver allows the five hundred employee limitation to be applied on a location-by-location basis with respect to hotels and food service businesses, without any aggregation among affiliates operating at other locations. Accordingly, so long as a given hotel location employs not more than five hundred employees, the subject business (if otherwise eligible under the Small Business Act) will be eligible for a Small Business Interruption Loan. Aside from the accommodation granted under the CARES Act to the hospitality and food services industries, many of the general limitations on eligibility under the Small Business Act remain in place and will be applicable with respect to Small Business Interruption Loans. Businesses that are generally ineligible include passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (subject to existing exceptions).

(ii) Maximum Loan Amount. Under the CARES Act, the maximum loan amount for a Small Business Interruption Loan will be the lesser of (1) $10 million or (2) two and one half times the average monthly payroll costs incurred by the applicant during the twelve month period immediately before the date that the loan is made (with seasonality-based adjustments and adjustments for new businesses being available). Additional proceeds may be available if a previously existing small business loan is being refinanced in connection with a Small Business Interruption Loan. Payroll costs are extensively defined under the CARES Act, and it should be noted that compensation in excess of $100,000 to any single employee cannot be included in calculating the maximum loan amount available to an applicant. As the CARES Act was intended, at least in part, to provide relief to the hotel industry, we expect that the payroll calculation provision will be construed to take into account typical ownership and employment arrangements utilized with respect to hotels. Accordingly, employees of a property manager that are assigned to a given location, with the hotel owner being responsible for payroll costs on a pass-through basis, should be considered employees of the applicant - noting that the applicant may be the fee owner of a hotel that has engaged a property manager or an operating company (in a REIT context) that holds a leasehold interest in a hotel pursuant to an operating lease, with such operating company having engaged the property manager. Note that the latest FAQ issued by the SBA specifically excludes payments made to independent contractors and it is questionable whether contract labor (much like that used by many franchisees in New York City) would be subject to inclusion.

(iii) Uses. Small Business Interruption Loans may be used for any purposes allowed under Section 7(a) of the Small Business Act, as amended. The permitted uses and limitations on use of proceeds of small business loans are set forth in the implementing regulations at 13 C.F.R. 120. Typically, small business loans may be used for a purpose benefitting the recipient's businesses, but payments to or on behalf of affiliates and speculative investment are generally prohibited. For clarity, and given that certain uses are required in connection with potential loan forgiveness (as discussed below), the CARES Act specifically allows the use of proceeds for the payment of the following costs (although such uses are not listed as exclusive): (1) payroll costs, (2) costs for continuation of employee benefits, (3) employee salaries, commissions, and other similar compensation, (4) interest on mortgage obligations, (5) rent, (6) utility charges, and (7) interest on other debt obligations incurred prior to the covered period (defined as February 15, 2020 to June 30, 2020). It should be noted, however, that the Interim Rule published in connection with the CARES Act requires that at least 75% of the proceeds of a Small Business Interruption Loan must be used for payroll. Although nothing in the CARES Act or the Interim Rule appear to limit when the loan proceeds must be utilized (other than in connection with the requirements for possible loan forgiveness), it is possible that additional requirements in this regard may be imposed.

(iv) Origination and General Terms. Small Business Interruption Loans will be administered pursuant to the Small Business Administration's Section 7(a) loan program, as modified by the CARES Act. The loans will be originated and serviced by existing banks and lenders presently enrolled in this program, as well as any other lenders designated by the Small Business Administration and the Secretary of the Treasury (the "Secretary"). A list of the 100 most active SBA 7(a) lenders through December 31, 2019 can be found at https://www.sba.gov/article/2020/mar/02/100-most-active-sba-7a-lenders. To promote the widespread availability of Small Business Interruption Loans, all such loans will be fully guaranteed by Small Business Administration. The deadline to apply for Small Business Interruption Loans will be June 30, 2020.

General terms of Small Business Interruption Loans as applicable to borrowers are to be as follows:

(a) The loans will be unsecured and will not require a loan guaranty;

(b) To the extent any portion of a loan remains outstanding following debt forgiveness (as discussed below), a maturity of two years will apply;

(c) An interest rate of 1% will apply; and

(d) Principal, interest, and fee payments with respect to the loan will be deferred for not less than six months and not more than one year.

(v) Loan Forgiveness. A centerpiece of the Small Business Interruption Loan program is the availability of loan forgiveness up to the entire principal amount of the loan. As discussed below, such forgiveness is (i) conditioned upon the use of loan proceeds for certain eligible costs, and (ii) subject to reduction based upon reductions in payroll. Borrowers will not recognize any cancellation of indebtedness income for federal income tax purposes with respect to forgiveness of any portion of a Small Business Interruption Loan.

In order for any portion of a Small Business Interruption Loan to be eligible for forgiveness, a borrower must make an application for forgiveness and confirm that 75% of the proceeds (or portion thereof for which forgiveness is sought) were used within the eight-week period following the loan funding to pay payroll costs.

Regardless of the use of the loan proceeds, a borrower seeking loan forgiveness must also confirm the levels of employment, salaries, and wages during the eight-week period following the funding of the loan. Subject to the overriding provisions of the following paragraph, the portion of the principal amount of the loan eligible for forgiveness will be reduced based on the ratio of (i) the average number of full-time equivalent employees employed during the eight-week period following loan funding, to (ii) the average number of full-time equivalent employees employed prior to the COVID-19 crisis (calculated, at the borrower's election, as the average number of employees either during the period from February 15, 2019 to June 30, 2019, or the period from January 1, 2020 to February 29, 2020). In addition, the portion of the principal amount of the loan eligible for forgiveness will be subject to reduction by an amount equal to the sum of all reductions of more than 25% in salaries and wages for employees as effective during the eight-week period following the loan funding (with reductions to be calculated on an employee-by-employee basis with reference to the most recent full quarter of employment for the given employee, and calculated without reference to employees paid at a rate of more than $100,000 per year during 2019 (calculated on an annualized basis for any pay period during 2019)).

The reductions in the amount of available loan forgiveness referenced in the preceding paragraph will not apply if (i) the reduction in the number of employees or the reduction in salaries and wages occurred during the period from February 15, 2020 to April 26, 2020, and (ii) the reductions are eliminated by June 30, 2020. The text of this override provision is fairly convoluted and appears to require the complete elimination of any reduction in the number of full-time equivalent employees and the complete elimination of any reduction in salaries and wages. Clarity on this matter may come through regulation. Regardless, an applicant that has already closed its property or significantly reduced its workforce should be mindful of these provisions in assessing the degree to which a Small Business Interruption Loan will be subject to forgiveness.

The application for loan forgiveness will involve a fair degree of detail. Determinations regarding forgiveness are to be made within sixty days of a lender's receipt of a completed application.

(vi) Other Considerations. Any applicant for a Small Business Interruption Loan should be mindful of any restrictions with respect to other indebtedness as contained in loan documents or other agreements to which such applicant is now subject. Such restrictions are common in mortgage loan documents and may apply regardless of the amount of a Small Business Interruption Loan and regardless of the fact that the Small Business Interruption Loan is unsecured and subject to forgiveness. Discussions with institutional lenders and major loan servicers suggest that existing lenders may impose escrow requirements to ensure that the proceeds of Small Business Interruption Loans are properly and timely applied. Also, given the anticipated volume of requests to senior lenders regarding Small Business Interruption Loans, applicants should be aware of potential delays, timing considerations surrounding re-openings, and the need to bring employees back into the workforce as a condition to loan forgiveness.

Any applicant that obtains a Small Business Interruption Loan under Title I will be unable to qualify for the Employee Retention Credit set forth in Title II of the CARES Act, which provides a payroll tax credit in an amount equal to 50% of the wages paid to an employee, up to $10,000.00 per employee.

2. Credit Support for Affected Businesses (Other Than Small Businesses). Title IV of the CARES Act (denominated as "Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy") provides additional forms of relief for businesses that are not classed as small businesses under the Act.

(i) Emergency Relief Funds. Under Title IV of the CARES Act, the Secretary is authorized to make loans, guarantees and other investments in support of eligible businesses, states, and municipalities in an amount not to exceed $500 billion. The CARES Act specifically provides up to $454 billion (in addition to any amounts not utilized for the other industry specific relief referenced in Title IV) for loans and loan guarantees to, and other investments in, programs or facilities established by the Board of Governors or the Federal Reserve that support lending to businesses, states, and municipalities. The CARES Act and Federal Reserve guidance contemplate a Main Street Lending Program ("Program") to be established by the Federal Reserve to support lending to small and mid-sized businesses. The Program will be comprised of three facilities (a) the Main Street New Loan Facility ("MSNLF") (new term loans up to $25 million with leverage capped at four times 2019 adjusted EBITDA); (b) the Main Street Priority

Loan Facility ("MSPLF") (new term loans up to $25 million with leverage capped at six times 2019 adjusted EBITDA); and (c) the Main Street Expanded Loan Facility ("MSELF") (add-on loan tranches up to $200 million to previously existing term loans or revolving credit facilities with leverage capped at six times 2019 adjusted EBITDA), each of which was authorized by the Federal Reserve and approved by the Treasury Department under Section 13(3) of the Federal Reserve Act. All three facilities will use the same eligible borrower and eligible lender criteria, and have many of the same loan features, including the same maturity (four year term), interest rate (adjustable rate of LIBOR (one month or three months) + three hundred basis points), deferral of principal and interest for one year, and ability of the borrower to prepay without penalty. The minimum loan sizes for MSNLF and MSPLF loans are $500,000 and $10,000,000 for MSELF loans. Borrowers must also make certain certifications and covenants: (1) the borrower will not repay the principal balance of, or pay any interest on, any debt until the loan is repaid in full, unless the debt or interest payment is mandatory an due (MSPLF borrowers may use proceeds to refinance existing debt owed to a different lender; (2) the borrower will not seek to cancel or reduce any of its committed lines of credit with the lender or any other lender; (3) the borrower has a reasonable basis to believe that it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file bankruptcy during that time period; (4) the borrower will comply with the borrower restrictions under Title IV of the CARES Act for the term of the loan plus twelve months, including restrictions on dividends, stock repurchases and executive compensation; (5) the borrower is eligible to participate in the Program and is in compliance with the conflict of interest provisions of Section 4019(b) of the CARES Act (relating to ownership interests by certain government officials and their family members).

(ii) Direct Loans to Mid-Sized and Large Businesses. The Federal Reserve announced the Program, which provides financing to banks and other lenders that make direct loans to eligible businesses with either fifteen thousand employees or fewer or 2019 annual revenues of $5.0 billion or less. Note, the program is now subject to the standard SBA affiliation rules in determining the number of employees and annual revenue. Unlike the PPP exception for NAICS 72, no exception is applied here. Thus, the majority of hotel ownership groups may not qualify for the Program, given employee and annual revenue limitations. Nonetheless, additional provisions applicable to such loans including the following:

(a) Except to the extent required by a pre-existing contractual agreement, the recipient will not pay dividends with respect to the common stock of the eligible business, or repurchase its (or its parent's) equity interests;

(b) A recipient must certify that it is organized in the United States and has significant operations in, and a majority of its employees are based in, the United States;

(c) Loan proceeds must be used to retain at least 90% of a recipient's work force, at full compensation and benefits, through September 30, 2020;

(d) Each recipient must make commercially reasonable efforts to maintain its payroll and retain its employees during the time the loans are outstanding "in light of its capacities, the economic environment, its available resources, and the business need for labor";

(e) A recipient must not outsource or offshore jobs or abrogate collective bargaining agreements, in each case, for the term of the loan and the two year period following repayment of the loan; and

(f) A recipient must not abrogate collective bargaining agreements during the term of the loan and for two years thereafter and, further, must remain neutral in any union organizing activity during the term of the loan.

With respect to the above item (e), the import is that any recipient could not determine whether there is continuing support for an incumbent union through an employer-initiated decertification petition, also known as an RM petition. Further, any recipient likely also gives up its right to file a motion under Section 1113 of the Bankruptcy Code to reject a collective bargaining agreement. While the full reach of the requirements of item (e) are still unknown, if an employer engages in an unfair labor practice that is found to have evaded the terms of the collective bargaining agreement, query whether this will be deemed to abrogate, in part, the collective bargaining agreement.

With respect to the above item (f), this requirement, obviously, could have significant implications for the hospitality and leisure industry. Although silence by the employer may not be required, any messaging during a union organizing campaign would presumable have to contain only view-point neutral content. Further, supervisors may feel stifled in their ability to communicate about their own experiences, which communications would otherwise be lawful. This provision does not appear to require an employer to enter into a neutrality agreement with any union seeking to organize its employees—noting that the terms of a neutrality agreement can vary drastically, ranging from on-site access for a union's agents to complete silence by an employer.

Unlike Title I loans, Title IV loans will not be subject to loan forgiveness and borrowers may be required to provide collateral. In addition, executive compensation is subject to limitation under Title IV. The Secretary's authority to make loans and investments under Title IV will terminate on December 31, 2020. Note that the Title IV funds will be subject to congressional oversight, which oversight the congressional committee will officially terminate on September 30, 2025.

3. <u>Tax Implications Under the CARES Act</u>. The CARES Act also provides for almost $600 billion in tax cuts, some of which are detailed below in D.4. It is important to note that certain tax benefits under the Act pertain specifically to employee retention.

(i) Employee Retention Credit for Employers Subject to Closure Due to COVID-19. Section 2301 of the CARES Act provides for a refundable payroll tax credit against Applicable Employment Taxes equal to 50% of qualified wages paid by Eligible Employers. An employer is an "Eligible Employer" in one of two circumstances (note that both sets of circumstances could well apply to a given employer):

(a) An employer will be an "Eligible Employer" for the period that starts with the first quarter of 2020 if its operations are fully or partially suspended due to COVID-19; or,

(b) An employer will be an "Eligible Employer" for the period that starts with the first quarter of 2020 where its gross receipts are less than 50% of its gross receipts for the same quarter in its prior tax year. An Eligible Employer no longer qualifies in the quarter *after* the quarter in which its gross receipts exceed 80% of gross receipts for the same quarter in its prior tax year.

Note that tax-exempt organizations whose operations were suspended due to COVID-19 are considered "Eligible Employers."

The credit is limited to the amount of Applicable Employment Taxes paid, reduced by any credits, including the credits provided for in sections 7001 and 7003 of the Families First Coronavirus Response Act (see PH COVID-19 Client Alert); however, if the amount of the credit exceeds this amount, the excess will be treated as an overpayment and refunded by the IRS. The credit covers the first $10,000 of an employee's "qualified wages," which includes wages and employer-provided health benefits that are properly allocable to those wages. This credit is available for qualified wages paid or incurred from March 13, 2020 through December 31, 2020.

Eligible employers who, on average, have more than one hundred full-time employees are entitled to claim the credit for (i) wages paid to employees when they were not working due to a COVID-19-related shutdown or (ii) due to the specified decline in gross receipts.

Eligible employers who, on average, have 100 or fewer full-time employees are entitled to claim the credit for all wages paid to employees during a COVID-19-related shutdown or during the quarter or quarters encompassed in the period wherein there is a "significant decline in gross receipts." The period where there is a "significant decline in gross receipts" begins with the first period in 2020 for which gross receipts are less than 50% of gross receipts for the same quarter in 2019 and ends with the calendar quarter *after* the quarter in which the employer's gross receipts are greater than 80% of gross receipts for the same quarter in 2019.

In addition, qualified wages paid or incurred by an eligible employer may not exceed the amount such employee would have been paid for working an equivalent duration during the thirty days immediately preceding such period.

Exclusions include:

(a) Wages paid to employees eligible for the Work Opportunity Tax Credit;

(b) Employees taking leave under the Family and Medical Leave Act; and

(c) Employers taking the Small Business Interruption Loan provided for under section 1102 of the Act may not take this credit.

(d) An employer that receives a PPP loan may not receive an Employee Retention Credit, regardless of whether and when the loan is forgiven (unless the employer repays the PPP loan by May 7, 2020).

(ii) Delay of Payment of Employer Payroll Taxes. Section 2302 of the Act allows employers to defer payment of 100% the taxes imposed by IRC section 3111(a) and allows self-employed individuals to defer payment of 50% of the taxes imposed by IRC section 1401(a). The amount deferred is payable over the 2021 and 2022 tax years: 50% of the amount deferred must be paid by December 31, 2021, and 50% of the amount deferred must be paid by December 31, 2022. Note that this only applies to the employer portion. Any taxes held in trust for the government such as withholding amounts should be continued to be remitted to the government in order to avoid any personal liability issues for directors or officers. Some additional exclusions apply, and counsel should be obtained in relation to any tax issues.

(a) Employers who have received a PPP loan may defer deposit and payment of the employer's share of Social Security tax that otherwise would be required to be made beginning on March 27, 2020, through the date the lender issues a decision to forgive the loan.

(b) Once an employer receives a decision from its lender that its PPP loan is forgiven, the employer is no longer eligible to defer deposit and payment of the employer's share of Social Security tax due after that date.

(c) The amount of the deposit and payment of the employer's share of Social Security tax that was deferred through the date that the PPP loan is forgiven continues to be deferred and will be due on December 31, 2021 and December 31, 2022.

(iii) Deductibility and Wages Paid with PPP Loan Proceeds. Tax payments made using PPP loan proceeds that are forgiven will not be deductible according to the IRS. This includes amounts paid for (1) payroll costs, (2) any payment of interest on any covered mortgage obligation, (3) any payment on any covered rent obligation, and (4) any covered utility payment.

B. NOT JUST AN INNKEEPER. When first approaching a distressed hotel or resort project, one must understand that there is much more to the project than meets the eye. The project is an ongoing business with many moving parts that must each be analyzed in great detail.

C. STAKEHOLDERS. Numerous stakeholders have vested and varied interests and their relationship to the Owner must be fully understood. Stakeholders include the Manager, Investors, lenders, tenants, employees, labor unions and their members, Unit Owners and spa and casino operators, licensing boards and other governmental agencies. The effects of COVID-19 may place a strain on these stakeholders and understanding each of these constituents and their relation to the troubled hotel asset is essential to successfully managing, owning and/or acquiring a distressed hospitality asset.

D. UNDERSTANDING THE CURRENT ENVIRONMENT.

1. Expected Headaches Made More Acute by Distress. If you are familiar with hospitality assets, you can probably rattle off a decently comprehensive list of the headaches of the hospitality industry, but add a helping of COVID-19 to the pot and your minnow now looks like a keeper. Particular attention should be paid to the fact that occupancy levels are near zero in major tourist destinations due to widespread travel restrictions and executive orders forcing closures or limited operations, along with unprecedented declines in RevPAR.

2. Minefields. The possible derailment of the ownership and operation model of the past few years (build aggressively, leverage endlessly, and reap the rewards) presents potential scenarios that were not previously on our collective radar screens:

   a. Control Over Operating Expenses. Cooperation or lack thereof in management's control over operating expenses.

   b. Default Under Loan Covenants. Declining RevPAR triggering default covenants in loan agreements.

c. Lack of Replacement Financing. Maturing loans and the inability to secure replacement financing.

3. “Trimming the Fat” to “Emerge Lean and Mean”. Owners can strategically manage a COVID-19 induced downturn by reducing operating expenses throughout all departments (and complying with jurisdictional restrictions), terminating any onerous operating agreements, if possible, and also examining their ability to renegotiate provisions of Collective Bargaining Agreements (“CBAs”) that the previous Owner may have had with the various labor unions. Navigating the waters may take a dash of optimism, but if you’ve been through a recession, you are aware of the opportunities such dislocation creates including, without limitation, (a) a purchase and sale of assets pursuant to section 363 of the Bankruptcy Code in order to eliminate unwanted and unknown liabilities; (b) assets becoming available at prices often far less than replacement costs; or (c) the “third owner” of a hospitality asset acquiring the same at a basis that makes economic sense for all stakeholders.

4. Tax Cuts under the CARES Act. As mentioned above, the CARES Act includes almost $600 billion in tax cuts. This includes changes to payroll taxes, the rules for net operating losses, as well as several other important modifications. Employee retention credit and delay of payment of employer payroll taxes is discussed above, and counsel should be obtained to advise on tax implications under COVID-19, but some other notable provisions of the Act include:

a. Modifications for New Operating Losses. Under the Act, net operating losses (NOLs) incurred in 2018, 2019, and 2020 may be carried back five years and may be used to fully offset income for tax years up to December 31, 2020.

b. “Straddle Year” Taxpayers. If a taxpayer’s tax year begins before the effective date of the Tax Cuts and Jobs Act (January 1, 2018) and ends after the effective date of the Tax Cuts and Jobs Act (December 31, 2017) (the “straddle year”) that taxpayer may within 120 days of enactment of the CARES Act elect to:

(i) Forgo any carryback of a loss incurred in the straddle year;

(ii) Reduce the period to which a loss attributable to that loss may be carried back; or

(iii) Revoke any election made to forgo any NOL carryback.

c. Modification of Credit for Prior Year Minimum Tax Liability of Corporations. Under prior law, IRC section 53(e) stated that corporations would be able to use their corporate alternative minimum tax credits in increasing amounts for tax years 2018 through 2021. In 2021, the credit would have been fully refundable. As a result of section 2305 of the Act, corporate taxpayers are now allowed to take fully refundable corporate alternative minimum tax credits beginning in tax year 2019 and may elect to take the entire refundable credit amount in tax year 2018.

E. MODIFICATION OF LIMITATION ON BUSINESS INTEREST. IRC section 163(j) generally limits business interest deductions to 30% of the adjusted taxable income of such taxpayer. Under the Act, during tax years 2019 and 2020, business taxpayers may deduct business interest up to the sum of business interest income, 50% of adjusted taxable income, and floor plan financing interest. For the 2020 tax year, taxpayers may also elect to use their 2019 adjusted taxable income.

F. SUPPLY AGREEMENTS. Many businesses are experiencing uncertainty in their supply chains caused by international restrictions, local operations shuttering due to illness or forced shelter orders, or shortages or redirection of material inputs. To protect against these business risks, industry participants may consider pursuing backup supply arrangements with their direct competitors. In such arrangements, if one competitor loses access to critical inputs due to economic effects of COVID-19, another competitor agrees to provide a certain level of supply to that competitor. Where contingency agreements may be beneficial, businesses should seek antitrust advice on the appropriate structure and safeguards for facilitating any necessary discussions and exchanges of information between competitors, to avoid risks associated with sharing competitively sensitive information.

G. LABOR ISSUES. COVID-19 has caused dramatic declines to many industries including travel, hospitality, and entertainment while others, such as healthcare, approach or exceed capacity. In deciding how to handle the health and safety of employees, as well as workforce and labor obligations, businesses may wish to confer with other industry participants on how to approach these issues. Discussion on many such topics may be timely and facilitate efficient operations in these uncertain times, but should nonetheless be approached with caution. Consistent with Department of Justice and the Federal Trade Commission pronouncements in their Antitrust Guidance for HR Professionals, antitrust enforcers will closely scrutinize any discussions or information sharing that may bear on employee hiring, wages and benefits. The agency guidance does, however, recognize that not all employment information sharing is illegal, and they have outlined methods for businesses to conduct such information sharing in compliance with the antitrust laws.

H. ASSET TYPES[4]. Understanding the hospitality asset type is essential to the diligence and valuation and, if necessary, repositioning of the asset.

1. Hotels.

   a. Branded vs. Unbranded. There are tremendous differences between hotels and resorts that are "branded" as compared to those that are considered "independent". The most important difference between a branded and independent hotel or resort is whether the underlying HMA or FA can be terminated upon sale. It has become the case that fewer branded HMAs are terminable upon sale, but if they are, there is likely a substantial lockout period that first must expire and, as a condition to the effectiveness of any such termination, owners must pay a potentially substantial termination fee (which is typically calculated as a multiple of the average aggregate base and incentive fees earned by the management company over the preceding twelve to twenty-four months, with the multiple based on how many years are remaining in the term of the HMA (which may include extension terms)). Similarly, FAs are not always terminable on sale, but if they are, are also subject to payment of a termination fee (calculated based on the number of remaining years in the term).

   b. Six-Star vs. Two-Star. For those of you who didn't know that there were such things as two-star properties, there are. But rarely do you need third-party advisors for the two-star properties (as they are often self-operated) and the FAs, if any, are cast in stone and not subject to negotiation (so we won't address these types of properties). On the other end of the spectrum, rarely do you see a six-star property, but when you do, these relationships (and the agreements governing these relationships) are typically very complicated. Six-star properties are generally smaller properties with costs per key in excess of $1,000,000. Such properties are managed by companies led by "artists" who don't believe in prescribed brand standard manuals and demand full autonomy in the operation and physical maintenance of the property, often for a VERY LONG time (fifty-, sixty-, seventy-, or eighty-year terms) and aggressively look to limit any Owner control. Fortunately, the vast majority of hotels and workouts are instead three-,

[4] We utilize the term "hospitality asset" to refer to various types of hospitality-related assets including hotels, resorts and mixed-use developments and their associated amenities such as golf, tennis, marina, and spas. We also refer to a developer/sponsor/managing member/general partner as the "Developer"; a limited partner/non-managing member as the "Investor"; a hotel operator/manager as the "Manager"; and an owner of a hospitality asset as the "Owner." Also, for convenience purposes, all hotel operating agreements, including HMAs, technical services agreements, license agreements, and third-party operator agreements, are collectively referred to as "HMAs," or, individually, an "HMA," unless otherwise specified. Purchasers and owners of the residential units of mixed-use hospitality assets are referred to as "Unit Owners."

four- and five-star properties. Most three-star properties are subject to a branded FA while most five-star properties are subject to a branded HMA. Four-star properties run the gamut from Owner-operated, to franchised with self- or third-party management, and full-blown brand-managed properties.

c. Onshore/Offshore (Foreign Hotel).

(i) In the event the effects of COVID-19 necessitate a sale, the most important issue typically facing an Owner ready to sell a hospitality asset at below basis, or perhaps at a price less than the secured debt, is the calculation of gain or loss. The trickier issues, however, arise in the context of possible phantom income resulting from debt forgiveness in connection with a foreclosure or even a deed in lieu of foreclosure (all of which is to be more specifically discussed later). If the hospitality asset is outside of the United States, however, one must understand that most international transactions take the form of a sale of the ownership in an entity rather than a sale of the assets themselves. As a result, the purchaser needs to be extremely careful (often having to engage a "Final Four" accounting firm with offices in the country in which the property is located) in order to analyze both hidden gain from a low tax basis inside of the owning entity, as well as the potential for value-added taxes and other assessments unique to the country in which one is doing business.

(ii) There are always local law issues, especially if you are involved in to-be-developed land or a building that is to be remodeled or expanded. In each case, a local lawyer and/or expediter will be necessary. Further, the transfer of liquor and other licenses fall under the jurisdiction of local regulatory law and must be addressed far in advance of the closing of a transfer. Finally, based on the applicable local law, one must immediately determine if a labor union will affect the construction or the operation of the hotel (or part thereof) and based thereon, address union issues (more specifically addressed below).

d. Urban/Resort Projects.

(i) As noted above and in more detail below, vertical properties (e.g., tall towers) tend to be located in urban areas (as opposed to resort areas) and often contain condominiums and a variety of other potentially third-party managed, if not owned, components that will have to be analyzed.

(ii) Horizontal properties (typically low-rise in a campus setting) are often found in resort locations and can usually be developed in multiple phases and thus pose less risk to all involved. On the other hand, horizontal developments often have related facilities that comprise hundreds, if not thousands, of acres.

2. Mixed-Use Properties (Restaurant, Retail, Casino, Spa, Golf Course). Whether a major urban tower or an expansive resort, if amenities such as golf, tennis, marinas or other major infrastructure are owned by the Developer and are part of the hotel or resort purchase (and likely subject to the same debt as the hotel or resort), the acquisition of the hospitality asset becomes more complicated (even more so if a homeowners association ("HOA") manages or perhaps owns such amenities in tandem with the Developer).

a. A Word on Tenants.

(i) 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, Italy, 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.

(ii) Depending on the circumstances, several other lease provisions may apply. In limited circumstances, these provisions may 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 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.

(iii) 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.

III. RECAPITALIZING JOINT VENTURES: GOOD MONEY AFTER BAD?

A. <u>TYPICAL OWNERSHIP STRUCTURES</u>. Most typical hospitality asset-owning entities are single-purpose entities (i.e., entities that own only one principal asset) comprised of a sponsoring partner and one or more an investing partner(s). Typical joint venture ownership structures include: (i) a limited partnership with a Developer and one or more Investor limited partner(s); (ii) a limited liability company with a Developer and one or more Investor non-managing member(s); and/or (iii) a syndicated limited partnership with a sponsor GP and multiple Investor LPs.

B. <u>TYPICAL FINANCIAL MODEL</u>.

1. <u>Promoter</u>. Typically, the Developer contributes little equity (5%-10%) and has day-to-day operation and management duties. The Developer will itself, or through an affiliate, develop and/or manage the development process and collect certain fees (construction management, asset management, acquisition and/or disposition fees, etc.). Also, a carried "promoted" interest will allow the Developer to share in the profits of the venture later in the transaction cycle if the hospitality asset is a success and the Investor has received certain hurdle returns on its investment. The Developer typically guaranties any construction cost overruns and oftentimes is required to execute a lender's non-recourse carve-out "bad boy" guaranties (provisions in a loan that can cause an otherwise non-recourse loan to have recourse due to certain bad acts on behalf of the borrower), completion guaranties, etc. The Developer will typically have day-to-day oversight responsibility of the Manager.

2. <u>Investor</u>. The Investor contributes most of the equity (often up to 95%) and has "major decision" rights and the ability to remove the Developer (and/or its affiliate) as the managing member, Developer and/or asset manager if there are any Developer defaults (which can include economic nonperformance of the project) and/or Developer affiliate defaults under related key agreements. In addition to the traditional "major decisions" (e.g., sale or refinance of the asset) such "major decision" rights also include, but are not limited to, selection and retention of the Manager, modifications to the HMA, approval of annual budgets and reserve and replacement requirements (e.g., reserves for furniture, fixtures and equipment ("FF&E") and reserves for capital replacement), approval of major employment contracts and agreements, approval of other ancillary operating

agreements (e.g., casino and spa operating agreements), and approval of retail and restaurant operators and agreements. In the case of a distressed hospitality asset, the Investor should have the right to make unilateral decisions relating to the company and the hospitality asset and any workout necessary to protect the Investor's existing equity investment, including whether or not additional capital contributions are necessary.

C. ISSUES WITH COVID-19 AND EXISTING JOINT VENTURES OWNING DISTRESSED ASSETS.

1. Additional Capital Needs. Today, a possible global economic downturn as a result of COVID-19 has already resulted in low to no occupancy at many hotels which will lead to declining RevPAR. This, coupled with other factors, such as poor hotel location, wrong brand, increased competition, aging improvements and facility, and poor marketing and reservations systems, may play a role in declining revenues. Whatever the reason, when revenues from the operation of the hotel are insufficient to cover debt service (and other ownership expenses) and the operating and maintenance costs of the hotel (including capital expenditures required, as applicable, by the branded management companies to comply with their respective brand standards), the result will be a troubled asset. In such an event, additional capital will be needed and can be obtained as follows:

a. From Within the Company.

(i) Pro rata contribution of additional capital by the members/partners.

(ii) Loans from one member to another that usually bear significant interest and are repaid by the member/partner from distributions that would otherwise be payable to such member/partner or subject to joint venture remedies.

(iii) Loans from one or more members to the company that bear significant interest and are repaid from cash flow prior to distributions of cash flow to members/partners.

b. From Outside Sources.

(i) As discussed above in section II ("Inn Trouble"), depending on eligibility under the Act and size of the business, the company could seek relief under the CARES Act in the form of a small business loan (under Title I), or, under Title IV, apply for emergency relief funds, a direct loan for mid-sized or large business, or, where relevant, multifamily loan forbearance.

(ii) The company could seek additional mezzanine financing secured by a pledge of ownership interests in the venture. However, in a distressed hospitality asset situation, mezzanine financing would likely be costly and, assuming there is an existing mortgage lender, time consuming to document. All existing lenders (and possibly the Manager) would have to approve any new mezzanine funding, especially given the possibility of a foreclosure and effective transfer of ownership interests to the mezzanine lender.

(iii) With the Tax Cuts and Jobs Act of 2017, lawmakers sought to synchronize the various definitions of "improvement property" that existed under old law, combine them under one new definition, and assign the new definition a 15-year cost recovery period so that it would be eligible for a 100% bonus depreciation provision. However, a clerical error prevented investments in Qualified Improvement Property ("QIP") from qualifying for bonus depreciation. This error had a large impact on retail businesses. This "glitch" is fixed by section 2307 of the CARES Act, which states that businesses may immediately deduct costs associated with improving QIP. QIP is defined under the Act as any improvement to an interior portion of a nonresidential building, as long as that improvement is placed in service after the building was first placed into service. QIP excludes expenditures for (1) the enlargement of a building, (2) elevators or escalators, or (3) the internal structural framework of a building.

(iv) New capital could be infused in the form of an unsecured loan from a partner affiliate to the company. Again, any such loan, even if unsecured, would likely require the approval of the existing lenders (and possibly Manager), though presumably such approval would be forthcoming if the affiliate loan is unsecured. If the company qualifies as a small business under the CARES Act, a Title I loan is likely preferable.

(v) In a distressed situation, if the asset is branded, an existing brand may be willing to be part of the solution and contribute key money; however, probably not without revision to the HMA reflecting a new economic structure and other concessions (which could include a longer term on the HMA, non-disturbance if none theretofore exists, the addition of a right of first refusal and/or a reduced radius restriction).

(vi) To raise additional capital in a distressed situation, the venture may opt to bring in additional Investors. Additional Investors under distressed circumstances, however, will typically require that their equity be preferred and that all existing equity and return on such equity be subordinated. If the venture is unable to raise capital to continue operations, any resulting foreclosure would result in forfeiture of all equity. Consequently, new sourced preferred equity may be a necessary alternative and is probably the most likely of all new capital sources into a distressed hospitality asset. As noted above, however, such new equity is likely to be quite "expensive."

(vii) Lastly, ownership and the management company (whether branded or unbranded) should look at existing working capital and FF&E reserves being maintained by the Manager as a potential source of capital to satisfy ongoing ownership or operating expenses (even if only a temporary solution). More flexible use of these reserve amounts would require agreement with the Manager (as the typical controller of such accounts) and may also require lender consent. Prior to use of such funds, ownership and Manager must determine the specific uses for such amounts, how much of any such reserves may be utilized and whether Manager will require ownership to reimburse any such amounts at a later date. In addition to looking to existing reserves, ownership should also seek a forbearance on future reserve requirements, such that these funds may otherwise be available for ownership to cover other, more urgent and pressing expenses (e.g., payroll).

2. Remedies for Failure to Contribute Capital in Violation of the Joint Venture Agreement. Joint venture partners will often have one or more of the following rights and remedies if a member (or its affiliate) breaches its monetary obligations set forth in the joint venture agreement:

a. Dilution. A squeeze down of percentage ownership interests with or without partner repurchase rights.

b. Guarantees. The enforcement of performance guaranties, cost overrun guaranties, completion guaranties (in a construction scenario), and partner performance guaranties.

c. Contributions. The enforcement of contribution agreements with affiliated entities (agreements made by affiliates of partners which require the affiliate to contribute capital on behalf of a defaulting partner).

d. Waterfall. The modification of the venture agreement's distribution waterfall to alter the economics of the venture.

e. Removal. The removal of defaulting partner(s) and termination of affiliate agreements.

f. Fees. The termination or suspension of the defaulting partner's fees.

g. Transfer. The acquisition by Investor of Developer's rights but not partnership interests. (Note: tax and accounting consideration.)

h. Change of Control. Structure to the consent of senior lenders, a transfer of day-to-day control of the Venture to the partner funding the "rescue capital."

3. Joint Venture Guaranties. In restructuring joint ventures and attempting to work out capital needs and deficiencies, it is important to note that payments by one or more joint venture partners on an existing guaranty will typically be something for which the joint venture will need to account. In addition, if a member is removed and/or forced out, any guaranty given by such member or its affiliate will likely have to be replaced. Guaranty obligations could include:

    a. Payment and Performance Guaranties. One or more joint venture members (often the Developer) may be obligated to execute and deliver construction completion guaranties, performance guaranties related to ancillary relationships (construction or asset management), and/or guaranties of the Owner's performance under the HMA and related agreements (e.g., technical services agreement or licenses).

    b. Loan-Related Guaranties. Lenders may require payment and/or performance guaranties, non-recourse guaranties and/or environmental guaranties/indemnities.

    c. Affiliate Guaranties. Often the joint venture structure and underwriting criteria mandate that a parent or affiliate guaranty its member/affiliate's capital obligation.

4. Exit Strategies. As with all troubled ventures, the need to remove a member or exit the deal altogether may come into play. Typical joint ventures have one or more of the following exit strategies:

    a. Buy/Sell. The buy/sell option is an option exercised by one of the venture partners (often following a lock-out period, except in the case of a default) wherein one venture partner offers to sell its interest or purchase the other partner's interests based on a prescribed method for determining the purchase price for the asset. In a distressed hospitality asset situation, such as that which may be created in a post-COVID-19 economic environment, issues may arise including: (i) valuation of the asset, (ii) the ability to raise necessary capital and/or financing to close on the acquisition, (iii) consent requirements of lenders and Managers (and possibly casino operators), and (iv) replacement of guaranty obligations.

    b. Forced Sale. Typically after a specified lock-out period, the Investor can force the sale of the asset (with the Developer having a potential right of first refusal to purchase the hotel). Issues similar to those noted above in a buy/sell scenario may arise.

    c. Remedies. In addition to those remedies noted above, in the event of a default by one or more of the members (or their respective affiliate) the defaulting member can lose voting rights or be removed entirely from the venture.

5. COVID-19 and Equity Compensation Values. When considering equity compensation valuations for federal tax purposes, it is important to recognize that the effects of COVID-19 may be a significant intervening event such that prior valuations may no longer be reasonable for equity compensation grant purposes.

   a. Section 409A – Option Exercise Price Valuations. Section 409A of the Internal Revenue Code of 1986, as amended, ("Section 409A") generally imposes adverse tax consequences on U.S. taxpayers who are granted options with an exercise price less than fair market value of the covered shares on the date of grant. For public companies, a fair market value determination is simple; fair market value is determined by reference to a publicly reported price, typically the per share closing price on the trading day before the date of grant or the closing price on the date of grant. For private companies, Section 409A requires that fair market value for option grant purposes be determined "by the reasonable application of a reasonable valuation methodology."

      Section 409A regulations contain a list of factors to be considered for a valuation methodology to be reasonable. These factors include various financial metrics, the market value of equity in similar companies engaged in substantially similar trade or business, which can be determined through nondiscretionary, objective means (such as publicly reported trading prices), and recent arm's length transactions involving the sale of the equity to be valued. Furthermore, a valuation determined by an independent appraisal, as of a date no more than twelve months prior to the option grant date, is presumed to be reasonable if the valuation meets the requirements of Section 401(a)(28)(C) of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

      Many private companies obtain an annual "409A valuation" to support option grant exercise prices. Often a private company board will rely on the valuation for twelve months. Private equity portfolio companies frequently rely on the private equity fund acquisition purchase price as an indicator of valuation for twelve months and then commence an annual valuation process. Venture capital-backed companies often look to financings within the prior twelve months as an indication of fair market value.

   b. Partnership Profit Interest Valuation. For companies that grant partnership profit interests, a similar valuation exercise occurs. Grants of profit interest awards must be structured to provide that the recipient is not entitled to any distributions if, immediately prior to the grant of the award, the partnership's assets were sold at fair market value and the proceeds were distributed in a complete liquidation of the partnership. Often, this is stated as requiring that holders of profit interest awards be entitled to benefit only from future appreciation or future profits. If a partnership grants an award that had been intended to be an award of profit interests, but the grant is based on a valuation less than actual current partnership fair market value, the award is taxed as a capital interest and not as a profit interest award.

   c. Consider COVID-19 Valuation Implications Before Granting Equity Compensation. Significant events, such as the business impacts of COVID-19, call into question prior valuations. Section 409A regulations provide that "the use of a value previously calculated under a valuation method is not reasonable as of a later date if such calculation fails to reflect information available after the date of the calculation that may materially affect the value of the corporation." A similar analysis holds for the grant of partnership profit interest awards—valuations should take into account all current information that may affect the value of the granting entity. Granting options with an exercise price greater than fair market value, while perhaps not intended, is not problematic from the tax perspective; a company may always grant premium priced options. Similarly, "premium valuation" profit interest awards do not result in a loss of profit interest status.

IV. RESTRUCTURING MANAGEMENT AGREEMENTS: WHEN THE RUBBER MEETS THE ROAD

A. WORKING WITHIN THE EXISTING AGREEMENT. If, during COVID-19 and after its impact is felt, the hospitality asset is generating positive cash flow, but the profits are not reaching the Owner, before exploring amendment or termination of the HMA, the Owner should first look to maximize its asset management rights over the hospitality asset by one or more of the following:

1. Shift Focus from Gross Revenue to Net Operating Income ("NOI"). Many hospitality assets achieve high gross revenues but that does not, in and of itself, assure either high net operating income or that available cash is making its way to the Owner. Conduct a line-by-line review of operating expenses to better understand how money is being spent and who is reaping the benefit of the expenditures.

2. Exert Stronger Asset Management. HMAs typically provide protections for the Owner to exert some control over the asset, including:

    a. Budget Preparation and Approval Rights. Is the Owner exercising its full range of rights in the budget preparation and approval process?

    b. Some Control of FF&E Reserves. Is the Manager unnecessarily spending the full amount of the FF&E reserve (or more) in excess of what is necessary to repair and replace FF&E due to ordinary wear and tear or to meet brand standards? Are there any carve-outs under the HMA that prevent such spending for brand standards, such as useful life rules?

    c. Working Capital Review. Is the working capital being retained by the Manager (in lieu of distribution to ownership) reasonable? Are there limitations on how much working capital Manager can withhold at any given time (e.g., no more than the operating expenses required for the immediately ensuring thirty to ninety day period)? And were the working capital amounts retained consistent with the then-current approved budget?

d. Audit Rights. Does the Owner have audit rights under the HMA? Have these rights been exercised?

3. Examine the Brand's Contribution to the Property.

   a. Optional Services. Are there any optional centralized services that the property could live without, particularly if the hotel is operating with minimal occupancy?

   b. Fair Allocation of Costs. Are there any centralized services programs (i.e., guest loyalty program) that are draining property's resources in light of occupancy levels and usage? Once the COVID-19 outbreak subsides, are redemption rights being disproportionately exercised at the property? Is this taking precedence over paying guests?

   c. Marketing. Is the brand's effort to market the property on par with its efforts on behalf of others in the chain?

B. RESTRUCTURING HMAs. With most hospitality assets currently being closed or operating with very limited staff, distressed properties may not generate enough to turn the property around even with the relief offered under the CARES Act, and Owners (and potentially purchasers) may attempt to renegotiate and/or restructure HMAs to ensure that the hospitality asset will remain operational and financially healthy. As a practical note, this may be a nonstarter for a Manager, especially if the Manager has been successful in obtaining a non-disturbance agreement ("SNDA") from existing lenders.

1. Why Would a Manager Modify the HMA? In a distressed situation where a hospitality asset is underperforming, a Manager may be open to modifying the HMA if (among other things) (i) the Manager is a true partner and wants to help the Owner survive a downturn, (ii) the Manager is unlikely to achieve the prescribed performance hurdles mandated by the HMA, or (iii) is not protected by an SNDA (and thus us more exposed to termination should there by a lender foreclosure).

   a. Proposed Temporary Modifications. Where there is room for negotiation with your Manager, consider ways in which minor or temporary modifications could be made, including:

      (i) Revising the fee structure or providing for a deferral of fees (including centralized services fees).

      (ii) Deferring the Owner's obligation to contribute toward FF&E reserves or to make (and fund) capital expenditures.

      (iii) Reducing staff and payroll expenses (particularly necessary in the current environment with COVID-19 leading to the possible decline of RevPAR and the need for a smaller staff to service a reduced occupancy base).

      (iv) Closing of certain nonprofitable areas of the hospitality asset (e.g., spa, golf course, marina and certain restaurants) and reaching an amicable termination of certain leases, licenses, concessions, etc.

      (v) Modifying the Manager's remedies, if appropriate, under circumstances where an Owner cannot advance funds as required under the HMA so that the failure to do so does not trigger termination rights and/or a significant damage claim.

b. Proposed Permanent Modifications. Where there is room for negotiation, consider ways in which to align both the Manager's and the Owner's long-term interests and to revise the HMA to reflect the market or the current trends in the industry. Such modifications could include:

(i) The Performance Test: What has come to be known as the "Performance Test," currently characterized as a Manager's failure to achieve, in any two consecutive years, both of the following:

(a) gross operating profit ("GOP") at a prescribed percentage of the gross operating profit set forth in the then-current annual budget; and

(b) RevPAR commensurate with the hotel's competitive set.

Given the possibility of a down market in the aftermath of COVID-19, while the abandonment of the RevPAR prong seems unlikely, it is possible that Owners again push for a replacement of the GOP prong in favor of a more "bottom-line" based NOI prong, thus infusing the Performance Test with renewed meaning.

(ii) Termination Upon Sale: Once a standard right included in every brand's term sheet, an Owner's right to terminate the HMA upon the sale of the hospitality asset to a bona fide third party has become almost impossible to obtain (particularly in gateway and rapid growth markets). However, these clauses can be incredibly important in a downturn, as Owners can sell distressed assets unencumbered at a premium to those looking to take advantage of the downturn to rebrand and reposition assets in the market. In addition, an economic decline caused by COVID-19 may lead to an increasing reluctance to finance hotels altogether (which have always been viewed as "riskier" assets), and lenders whose Owners fail to obtain the right to terminate upon foreclosure may insist on its Owner having the right to terminate the HMA upon the sale of the hospitality asset (so as to maximize the lender's ability to sell the asset following a foreclosure and maximize its proceeds on exit). With the right to terminate the brand upon sale, the asset becomes unencumbered (and more valuable) in the eyes of a purchaser, and the brand must make its case to a successor owner if it wants the asset to retain its flag.

(iii) As discussed above, Owners will exert greater control over capital expenditures and spending out of the FF&E reserve. Owners and lenders should require stronger limitations on replacements of FF&E and spending out of the FF&E reserve (i.e., no capital replacements prior to the end of an item's useful life; no expenditures in any one category in excess of a designated threshold amount; and approvals over spending in excess of the FF&E budget even if funds are available).

2. Are There Alternative Reasons to Modify the HMA? Where having a contractual right to terminate is not an outright option, is there another brand under the umbrella of the parent brand company that would be more viable in the current market? With the high cost of reflagging a property, is there an affiliated or "soft" brand that might better meet market demands, in the face of the aftermath of COVID-19, without requiring extensive capital costs?

C. TERMINATION OF THE HMA. What if the Manager refuses to take the steps necessary to protect an Owner (e.g., as noted above, by a reduction of operating expenses or a modification of the HMA; etc.)? Does brand affiliation add to or subtract value from the asset? What about the Manager? If the brand does not add value, and in anticipation of a market with ever-declining RevPAR and distressed hospitality operations, an Owner (or purchaser) should, if it makes sense, scrutinize the HMA for opportunities to terminate the Manager as follows:

1. Contractual Right to Terminate. The HMA, particularly in a distressed environment, might provide the Owner with the right to terminate the Manager "for cause". To this end, examine potential areas of the Manager's non-performance under the HMA as follows:

   a. Maximize Cash Flow. Is there an Owner-oriented operating covenant in the HMA to maximize profitability, cash flow or NOI (or similar metric) over the short or long term?

   b. Control Expense. Is there an obligation to minimize controllable expenses?

   c. Operating Budgets. Are operating budgets being prepared in compliance with the foregoing operating covenants? Is Manager seeking subsequent approvals from Owner for deviations from the budget where applicable?

   d. Reporting. Have reports been delivered on time and in accordance with the formats described in the HMA?

   e. Accounting. Has accounting been done accurately and in accordance with GAAP and/or the terms of the HMA?

   f. Special Covenants. Are there general agency or other covenants that the Manager has failed to perform?

2. Termination in Breach of the HMA. Where the Owner and its lawyers and accountants have reviewed the HMA and analyzed the potential for breach thereunder but cannot make the case for termination, the Owner may ultimately decide to terminate the HMA, even if in breach thereof, in an effort to stave off foreclosure or bankruptcy (e.g., in order to take control of the budget process and thereby drastically reduce operating expenses or in order to sell the asset free and clear of the management agreement; etc.). It is true that a termination by the Owner in breach of the HMA may result in damages to the Owner, but Owners in most circuits in the United States nevertheless do have the authority to terminate the HMA because management contracts (including HMAs) are not interests in real property unless they are deemed "an agency coupled with an interest" (which, as a general rule, exists only where the Manager has made an equity investment in the hospitality asset itself). Moreover, the Manager's damages may well be limited by a variety of factors (e.g., they should include only base and incentive fees and specifically exclude centralized services reimbursements, allocations of the costs of advertising and promotion, reservation fees and other reimbursements to the Manager). Those damages, however, might be further mitigated by excluding option terms and/or the costs that the Manager would have incurred in providing the management services, and the payment of damages may potentially be eliminated altogether in bankruptcy (which is explained in more detail in *Chapter X: Navigating Through Bankruptcy).*

D. TRANSITION OF MANAGEMENT FOLLOWING A TERMINATION OF THE HMA. A well-drafted HMA will detail the parties' obligations following termination (just as it is often wise to discuss the terms of a divorce in a prenuptial agreement prior to entering into a marriage, the ideal time to discuss and agree on terms regarding the transition of management of a hospitality asset in the event of a termination of the HMA is prior to executing the HMA). Unfortunately, many HMAs lack such terms. In such a case, a termination of the HMA will likely result in a disorganized and perhaps contentious transition of management, particularly where most hotels are currently closed or operating under skeleton crews due to the current environment and COVID-19 (which may further adversely affect revenues as well as the hospitality asset's relationship with guests and employees). In order to facilitate a smooth transition to new management and if not addressed in the HMA, the following items should be set forth in a separate termination and transition agreement between the parties:

1. Outstanding Fees and Expenses. Upon termination, the Manager is typically entitled to receive payment of all accrued and unpaid management fees (including the base fee and incentive fee), reimbursable expenses and centralized services fees and charges calculated through the effective date of termination. To the extent such amounts are reasonably ascertainable as of the effective date of termination, the Manager is typically entitled to withdraw such amounts from the hospitality asset's bank accounts on or prior to the effective date of termination. To the extent any amounts due and owing to the Manager are not reasonably ascertainable as of the effective date of termination, such amounts are generally paid by the Owner to the Manager within a reasonable time following the effective date of termination (e.g., ninety to one hundred twenty days). In the event the parties execute a separate termination and transition agreement, the Owner should consider attaching, as an exhibit to the agreement, a schedule of all management and other fees, costs and reimbursements and other expenses owed to the Manager by the Owner pursuant to the terms of the HMA so that the Owner will know prior to the termination date all amounts due and owing to the Manager.

2. Financial Closeout; Books and Records. No later than the effective date of termination of the HMA, the Manager should relinquish to the Owner all funds of the Owner with respect to the hotel that are held by the Manager in the various bank accounts of the hospitality asset: provided, however, the parties may agree that the Manager shall relinquish to the Owner only those amounts in excess of any remaining payables, obligations and expenses of the hospitality asset. Any funds received by the Manager following the effective date of termination should be immediately remitted to the Owner. In addition, upon the effective date of termination, the Manager should assign and transfer to the Owner all books and records respecting the hospitality asset that are in the Manager's control to ensure the orderly continuance of the operation of the hospitality asset: provided, however, the parties may agree that notwithstanding such transfer, the books and records will be available to the Manager for inspection, audit, examination and transcription for a period of time following the termination (e.g., two to three years). Finally, the Owner should make sure it receives both a hard and an electronic copy of such books and records in a format that is accessible by the Owner (e.g., not in an electronic format requiring any proprietary software to access, read, or edit such information).

3. Contracts and Leases. On or prior to the effective date of termination, all contracts and leases held by the Manager should be assigned and transferred to the Owner (or Owner's designated management company). The Manager should schedule all applicable contracts and leases that can or should be transferred. The Owner should review all contracts and leases to ensure that such agreements can, in fact, be assigned and, to the extent any consents are required, the Manager should assist.

4. Licenses and Permits. To the extent permitted by applicable law, all permits and licenses held by the Manager relating to the operation of the hospitality asset, if any, should be assigned and transferred to the Owner on or before the effective date of termination. Typically, if the Manager has expended any of its own funds in the acquisition of such licenses and permits, then the Owner would reimburse the Manager for such expense. Unless there are gaming licenses, the most important license to be considered is the liquor license. If the Manager or an affiliate of the Manager is the holder of any liquor license for the hotel asset, then the Owner and Manager may need to enter into an interim beverage agreement or temporary lease whereby the Owner would have the right to use the Manager's license for the continuous and uninterrupted sale of alcoholic beverages at the hospitality asset until such time as the Owner is able to obtain its own liquor license.

5. Securing the Hotel. On the effective date of termination, the Manager should deliver to the Owner all keys, locks and safe combinations: provided, further, for purposes of securing the property, the Owner should ensure that (i) all master keys of any kind are deleted from the system and reissued and reassigned, as necessary, (ii) all keys and combinations are changed for areas such as the

Manager's former offices, storage, equipment and any safe and departmental banks, and (iii) all property systems are controlled (e.g., the guest room locking system, front and back office computers, and individual software programs, including accounting, food and beverage, payroll and time clock).

6. FF&E and Operating Supplies. The Owner should receive from the Manager a current inventory of all assets of the hospitality asset, including the FF&E, operating equipment and operating supplies. In addition, to the extent any FF&E, operating equipment or operating supplies bear the trademarks of the outgoing Manager, the parties should determine whether (i) the Manager will have the option or be required to purchase such FF&E and/or supplies and at what price (e.g., at cost or fair market value), or (ii) the Owner will have the right to use such items for a short period following the effective date of termination (although this may be an unlikely alternative, particularly if dealing with a major brand)..

7. Room Rentals and Advance Bookings. Upon the effective date of termination, the Manager should provide the Owner with a complete list of: (i) all bookings for future reservations or use of hotel rooms or facilities that the Manager may have accepted or entered into at any time prior to the termination of the HMA, (ii) the terms applicable to such bookings and (iii) the amount of advance deposits (if any) received with respect to each such booking. Typically, the Manager will continue to book reservations at the property in the ordinary course of business through the effective date of termination and the Owner should ensure that the Manager also agrees that it will not solicit the redirection of any existing, incoming or new reservations for dates occurring after the effective date of termination to other properties managed or owned by the Manager or its affiliates. In addition, the Owner should ensure that the Manager will not book reservations for dates after the effective date of termination for groups or individuals at rates lower than the prevailing market rates for any given room or the use of public space at the property, without the Owner's prior written consent. In addition to the foregoing, the Owner should consider the following in connection with COVID-19:

   a. Existing Contracts. 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.

   b. Possible Applicability of Force Majeure. 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 the 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.

c. Economic Difficulties Do Not Apply. The mere occurrence of unfavorable economic conditions (bans on travel, for example) brought on by COVID-19 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.

d. Impracticability. 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.

8. Taxes. The Manager should prepare a complete schedule, as of the date of termination, of all unpaid real estate taxes, personal property taxes, room taxes, sales taxes, entertainment taxes and any and all other taxes and/or assessments levied against the property, along with information regarding the date(s) on which such taxes and assessments are to be paid. Note that, due to COVID-19, tax filing deadlines have been extended for nearly every state. New tax deadlines and additional tax implications related to COVID-19 should be considered in every jurisdiction where a business operates as part of any tax assessment.

9. Proprietary Information and Software. As of the effective date of termination, the Manager will remove all proprietary software and will disconnect the property from the reservations systems and their related software applications. Given the current climate with hospitality assets, it is imperative that the Owner coordinate with its new management team to ensure that new systems and software are installed to avoid further disruption in the operation of the property. Typically, the Manager will agree to cooperate with the Owner and new management in connection with the transition from the proprietary software owned by the Manager to one or more replacement systems. To the extent the Owner determines that it is necessary to facilitate the orderly transfer of the Owner's records and data, and to the extent permitted by the terms of the licenses with software owners/licensors and at the Owner's request, the Owner and the Manager will enter into a form of software license agreement to provide for the use by the Owner of appropriate proprietary software for a specified period of time following the effective date of termination.

10. Guest Information. The Owner and the Manager both want the benefit of retaining the guest information derived from operations at the property as it is an extremely valuable asset. The Owner typically argues that the guest information is part of the books and records and thus rightfully belongs to the Owner. The Manager, however, will be concerned with the privacy rights of the guests and will not want to be the target of lawsuits, bad press or guest ill will as a result of the Owner's use of the guest information and, therefore, may argue that guest information constitutes the Manager's proprietary information. A compromise is that the guest information be jointly owned by both parties (although this has been increasingly difficult to negotiate with the branded management companies).

11. Telephone Numbers and Web Sites. To the extent any telephone services (including any associated telephone numbers) or websites (including ownership of any domain name registration

and any artwork, design, copy, photography or computer programming associated with such websites) dedicated to the hotel are held by the Manager, the Owner should ensure that the Manager assigns and transfers to the Owner its interest in such web sites and/or telephone numbers.

12. Insurance. In the event any part of the property is included in the Manager's insurance program, such participation will typically be terminated as of the effective date of termination, so it is important that the Owner make other arrangements for its insurance needs following the effective date of termination, whether the Owner obtains its own insurance or becomes a part of the new Manager's insurance program. The Manager will have the right to reimburse itself for any insurance premiums which may have accrued through the date of termination and typically is entitled to withdraw the appropriate amount from the funds held in the operating accounts of the hospitality asset. If the Owner's pro rata share of premiums under the chain wide policies of insurance have been paid in advance, however, then the Manager should reimburse the Owner for the unearned portion of insurance premiums (to the extent such apportionment is available from the insurer).

13. Receivables. All receivables that are outstanding as of the effective date of termination, including, without limitation, guest ledger receivables, will continue to be the property of the Owner. The Manager will typically agree to cooperate with the Owner in the collection of any receivables and will agree to turn over to the Owner any receivables collected directly by the Manager after the effective date of termination which relate to business conducted during the term of the HMA.

14. Employees. Because hospitality assets are labor-intensive operating businesses, the retention of employees is often crucial to seamless operation of the property. Under most HMAs in the United States, employees are employed by the Manager and most HMAs call for the termination of all employees upon termination of the HMA (in compliance with the Worker Adjustment and Retraining Notification Act (the "WARN Act"). Often the purchaser or, if applicable, the new Manager of the hospitality asset, will hire the majority of employees back, with the exception of higher-level management employees. *See Chapter VI: Working with Labor* for a more detailed discussion of labor and employment issues, and consider the implications of any loan taken out under the CARES Act (especially Title I thereof) as the forgiveness of such loans is likely to be impacted by the termination of employees.

15. De-Identification of the Hotel. From signage to stationery to soap, upon termination of the HMA, the property must be cleansed of all identifications associated with the brand.

16. Cooperation. Lastly, the Owner should ensure that the HMA or termination and transition agreement contains an affirmative covenant requiring the parties to cooperate with one another and to act in a professional manner to effect an orderly transition of management functions from the Manager to the Owner, any transferee of the Owner or to any managing agent designated by the Owner.

V. PURCHASING DISTRESSED HOSPITALITY ASSETS: WHAT YOU DON'T KNOW WILL HURT YOU

A. DUE DILIGENCE. The diligence that must be conducted on a distressed hospitality asset exceeds the customary due diligence performed on other types of real estate (including office, retail, multifamily and industrial — all of which are passive investments that are not operated as a business by a third party for the profit or loss of the entity that owns the project). Although a proper due diligence list is perhaps ten or more pages long, the following are three major areas of concern in the wake of the COVID-19 pandemic (each of which is addressed in more detail elsewhere in this book):

1. HMAs. Prospective purchasers should conduct due diligence on any existing HMAs and related documents to determine whether they contain current market terms, or whether costs and expenses, required services, marketing contributions and the like are nonmarket or exploited by the Manager and what changes may create cost savings or increase revenue, particularly now where occupancy levels are low and are expected to remain that way for the foreseeable future. If at all possible, the purchaser should prepare a detailed estoppel certificate for the Manager to execute. A well-crafted estoppel certificate can disclose existing issues and potential or impending issues. Such issues are likely to be worse the longer that the hospitality asset has been in a distressed mode (e.g., capital reserves could have been diverted from FF&E replacements to cover negative operating deficits in a down period or levels of inventory may be less than inventory levels needed in prior years to fully and successfully operate the hotel as the Owner does everything possible to conserve cash, etc.). *See Chapter IV: Restructuring Management Agreements* for a more detailed discussion.

2. Mixed-Use Projects. In a mixed-use project that contains commercial, residential, condo-hotel, condominium and/or timeshare or fractional components, a purchaser must conduct thorough and detailed due diligence on all documents involved in the purchase and sale process. If the project is financially troubled, a purchaser intending to work-out the hospitality asset must understand the revenue and expense sharing aspect of the project, the adequacy of assessment procedures, what control the various owners, including the Unit Owners have of the common areas and the possibility of construction defect litigation from residential owners. Often, the original Developer will structure the HOA assessments artificially low with the goal of accelerating sales of residences and with the intention of increasing HOA fees after the sales process is complete. The unfortunate

consequence, however, is that residence sales may be slower than expected (thereby forcing the Developer to maintain the HOA assessments at those low and arbitrary levels for longer than expected) and/or the Unit Owners turn out to be far more resistant to planned increases by the Developer than the Developer expected, thereby leaving the hotel to subsidize the operating costs of the common areas (and reducing the value of the hotel). *See Chapter XI: Analyzing Mixed- Use Hotels & Resorts* for a more detailed discussion.

3. Labor and Employment Issues. The human resource is a fundamental aspect of the economic and operational viability of the transaction as well as the timetable for the recovery of a distressed hospitality asset. Labor and employment related costs represent one of the largest categories of hospitality asset expenses. Identifying and quantifying, and then controlling and/or reducing these costs and expenses is vital to successfully turning around a distressed hospitality asset. Accordingly, purchasers should perform thorough and early due diligence on labor- and employment-related issues (especially if the purchaser intends to reduce payroll expenses or other related costs and expenses). Again, an estoppel certificate signed by the Manager will help identify lawsuits that have been threatened, but not yet filed, by disgruntled employees who thought they were unfairly targeted when the Owner or the Manager started to reduce the workforce at the start of the economic decline. *See Chapter VI: Working with Labor* for a more detailed discussion.

B. ACQUIRING THE HOTEL ASSET.

1. The Asset Purchase Agreement. The purchase of a hospitality asset usually contemplates the continuation of an ongoing business and involves operational issues not common (as noted above) to other real estate classes. In the case of a distressed hospitality asset, the purchase agreement becomes the purchaser's tool: (i) to require the seller to continue to operate the property in the ordinary course until the purchase can be consummated (which sometimes may be through a Chapter 11 or other court proceeding), (ii) to require certain estoppels and representations and warranties from third parties who are integral to the operation, revenue and expenses of the hospitality asset (e.g., the manager, operators, HOAs, labor unions and major retail and restaurant owners) and the seller, respectively, with a particular emphasis on those items that are typically exacerbated during a period of distress in the hospitality industry (some of which are identified above) and (iii) to provide purchaser rights of termination if certain factors during the contract period have a material and adverse impact on the hospitality asset. For example, a distressed hospitality asset is by practice and definition performing poorly so the seller may not accept a decline in RevPAR (which is a current reality for many hospitality assets generally during the COVID-19 outbreak and is likely to continue for months afterward) and average daily rates as an excuse (i.e., "material adverse change") giving rise to the purchaser's right of termination and a return of the purchaser's deposit. Additional factors constituting a "material adverse change" include the filing of a Chapter 13 bankruptcy petition on behalf of one of the borrowers or guarantors; the failure of the property's secured lender to fund the balance of a construction loan that is needed to complete or to renovate a project and/or the filing of a lawsuit against the seller that would exceed a fairly high bar or that would threaten the seller's right and authority to sell the property.

2. Special Considerations in the Purchase of Distressed Hospitality Assets. When buying a distressed hospitality asset, there are a number of unique issues not necessarily found in other property transactions, some of which are noted below:

   a. Excluded Liabilities. When purchasing a distressed hospitality asset, there will be a number of known and unknown (or discovered during due diligence) liabilities that the purchaser will want to expressly exclude from the acquisition, especially since it is likely that these obligations have arisen because the hospitality asset is operating during a period of distress. These liabilities often include, but are not limited to:

(i) indebtedness, obligations and guarantees not specifically assumed;

(ii) accounts payable or other trade payables of the seller or any of its affiliates except with respect to which the purchaser receives a credit against the purchase price or for those items included on an approved balance sheet;

(iii) obligations and liabilities arising under, related to, or by reason of any and all contracts (including the HMA, particularly if the HMA was not terminable upon sale);

(iv) obligations and liabilities relating to acts or omissions of the seller or any of its affiliates, employees, agents or independent contractors (whether arising under assumed contracts or otherwise) occurring prior to the closing;

(v) any pre-closing federal, state, local or special purpose district tax obligations and liabilities and withholding tax obligations of the seller or any of its affiliates (especially to the extent the seller has agreed to a forbearance of taxes during COVID-19 which could result in taxes for the seller's period of ownership becoming due and payable after the purchaser's acquisition), including any interest, additions to tax, loss of elections, fines or penalties thereon or in respect of returns filed or required to be filed in connection therewith;

(vi) obligations and liabilities arising from the termination, discharge, layoff or other separation from employment of the seller's or any of its affiliates' employees prior to the closing (again, the layoff of employees is often the first and quickest way to cut expenses in times of reduced occupancy and RevPAR and it's often those employees who decide to sue the seller after the change in ownership);

(vii) obligations and liabilities arising as a result of any grievances or unfair labor practice charges, discrimination or retaliation claims, wage and hour claims and/or unemployment compensation claims, in each case for periods prior to the closing;

(viii) obligations and liabilities for any workers' compensation premiums or claims or for any common law or statutory claims by an employee or other individual, firm, corporation, partnership, entity, limited liability company, incorporated or unincorporated association, joint venture, joint stock company, governmental agency or instrumentality, or any combination of the foregoing for any injury, occupational disease, aggravation of a previously existing injury or disease, or all other matters for which a claim could have been brought prior to closing (again, it is easy to imagine a laid-off employee deciding to make a workers' compensation claim after the fact);

(ix) obligations and liabilities arising from the violation of any federal, state or local statute, law, ordinance, order, rule or regulation pertaining to health, industrial hygiene, hazardous materials or the environment;

(x) obligations and liabilities relating to, or arising from, any leases of real estate or equipment between Owner and any of its affiliates or any third party except for post-closing obligations with respect to any such leases being assumed by purchasers;

(xi) obligations and liabilities relating to or arising from post-retirement healthcare benefits owed or to be owed by the seller to its employees or former employees, as the case may be (see below);

(xii) obligations and liabilities under or in connection with any "welfare benefit plan," as such term is defined in § 3(1) of Employee Retirement Income Security Act ("ERISA"), or "pension plan," as such term is defined in § 3(2) of ERISA, with regard to the period prior to closing, except as to benefit claims with respect to the assets transferred from Owner's 401(k) Plan (again, in a distressed environment, contributions to pension plans are often the last expenditures an Owner wants to make when it can't even pay operating expense, let alone debt service);

(xiii) obligations and liabilities arising from Owner's or its affiliates' employment of their employees, whether imposed by operation of any federal, state or local statute, law, ordinance, order, rule or regulation or any common law right or obligation, employment agreements or contracts, employee manuals or handbooks or personnel policies or otherwise, including, but not limited to, any wage claims, holiday, vacation, personal day and sick pay benefits, severance or layoff benefits, employee health (including claims for COBRA coverage), welfare and pension plan benefits, Section 401(k) of the Internal Revenue Code of 1986, as amended (the "IRS Code") and profit sharing and bonus plan benefits, WARN Act obligations, pending grievances and/or arbitrations, back pay and/or benefits, any other Taft-Hartley Fund benefits, pension fund withdrawal liability workers' compensation liabilities, savings bonds and wage garnishments or assignments, employment discrimination, wrongful termination or similar claims arising from acts or omissions occurring before the closing date, except as to benefit claims with respect to the assets transferred from Seller's 401(k) Plan or as otherwise required under the National Labor Relations Act, as amended (29 U.S.C. §§ 151 et seq.);

(xiv) obligations and liabilities with respect to goods or services or to the purchase of goods or services to the extent the goods were delivered or the services were rendered prior to or at closing;

(xv) security and other deposits, advance or prepaid rents, and key money (including any interest thereon) not credited to the purchaser and held by the seller from tenants of the premises with leases in effect as of the closing date assumed by the purchaser as assumed contracts;

(xvi) obligations and liabilities for purchase money obligations whether structured as debt, lease or otherwise (usually this is not a problem since the title company will require pay-off demands or other estoppel certificates before closing, but, nevertheless, be wary!);

(xvii) obligations and liabilities for due bill contracts or other "trade-out" liabilities, unless Owner pays purchaser for the same at closing;

(xviii) obligations and liabilities relating to work performed or building materials furnished during the period prior to or at the closing date whether under architectural, engineering and construction contracts or subcontracts or otherwise (particularly if the nonpayment of any amounts due thereunder could give rise to mechanics' liens); and

(xix) obligations and liabilities for food, merchandise, rooms, show tickets or other complimentary items issued to third parties for services or goods furnished to the business prior to or at the closing date.

b. Special Closing Conditions for Acquisition of a Distressed Hospitality Asset. A purchaser of a distressed hospitality asset should insist upon certain conditions (in addition to standard closing conditions), including:

(i) No material adverse change (including bankruptcy of the seller or additional notices of default under loans) in the financial condition of the property, borrower or the Manager;

(ii) Receipt of estoppel certificates from the Manager, tenants of retail leases, HOAs, casino operator, spa operator and/or golf course manager, as applicable, which set forth detailed representations regarding revenue and expenses and any other existing or pending financial obligations of the parties as well as certifications regarding the unknown liabilities noted in the prior section;

(iii) Transfer and assignment of intellectual property rights, whether owned or licensed by the seller. The rights to be transferred and related concerns may include (a) trademarks, whose assignment require the transfer of associated goodwill and a filing with federal and/or state trademark registration authorities; (b) trade names, whose transfer may require filing with local authorities an express abandonment by the seller of such trade names; (c) Internet domain names, whose transfer typically require compliance with the specific Internet registrar's transfer protocols; (d) copyrights, whose transfer require, in the case of registered copyrights, a filing with the Registrar of Copyrights or similar officials in foreign countries; and (e) databases, whose transfer may require compliance with relevant privacy and data security laws or regulations. Note that often in distressed hospitality asset settings the seller stops taking the necessary steps to protect its rights in intellectual property and stops taking the extra precautions needed to ensure the rights are in fact perfected and have continued to be maintained in accordance with applicable law.

(iv) Liquor license transfer or third-party lease (see *Chapter XIII: Acquiring Assets With Gaming & Liquor*);

(v) Assignment and assumption, or not, of third-party leases; and

(vi) Audit of inventory (all of consumable, FF&E and for sale).

c. Special Post-Closing Protections. As noted above, most Owners of hospitality assets are single-purpose entities (in fact, their lenders will require this) and consequently there may be insufficient assets standing behind representations, warranties, operating covenants or any other promises made by the seller under the purchase agreement. Consequently, a purchaser will need to attempt to obtain parent or affiliate guaranties, letters of credit or an obligation on the part of the seller to escrow funds (of which there may be very little net proceeds) during the post-closing claims period, to satisfy claims against violations of these representations and warranties. In addition, any claims period when acquiring a troubled asset should extend to a minimum of twelve months to ensure at least one year of operating history to confirm the accuracy of representations and warranties regarding the operations of the hospitality asset.

3. Additional Considerations Arising from COVID-19.

a. Timing. Parties should anticipate and prepare for potential interruptions and delays to transaction timelines, particularly to the extent that the parties require government or other third party agency involvement or cooperation, including, without limitation, the issuance of licenses (including liquor licenses), the recordation of deeds (for which title companies in applicable states are incorporating additional language in so-called standard "gap indemnities" to take into account potential longer delays in recording that was is typical as a result of the local and state "Safer at Home" mandates arising due to COVID-19?), etc.

b. Scheduling Meetings. Parties may experience difficulties in scheduling in-person meetings and site visits due to travel restrictions and/or other containment protocols that alter ordinary business operations of the seller and third-party consultants assisting in the transactions. Purchasers, for example, should account for these potential delays in negotiating exclusivity provisions. More generally, parties should be considering whether there are potential alternatives (e.g., videoconferences) that avoid the need for in-person meetings. For example, the SEC has recently issued guidance on the validity of holding annual general meetings virtually.

c. Responses to Due Diligence Requests. Containment protocols that alter the ordinary course of business operations of the seller of a distressed hospitality asset may also impact the seller's ability to respond to due diligence requests in a timely manner, particularly if the seller does not have the technological infrastructure in place to allow its employees to effectively work from home. The parties should make sure they understand the extent of the seller's capabilities (and potential deficiencies) on this front as early as possible in the process.

d. Regulatory Approvals. The implementation of containment protocols by government agencies in the United States and abroad could impact the timing for obtaining regulatory approvals required in connection with a potential transaction. Parties should account for these potential delays in negotiating the outside date in the PSA, including the instances in which the outside date may be extended.

(i) Due Diligence Generally. In addition to the timing implications discussed above, purchasers should also expand the scope of their due diligence to address COVID-19 specific concerns.

(ii) Internal Policies. Purchasers should ensure that their due diligence includes a review of any internal policies, procedures, and/or protocols the seller currently has in place to address COVID-19, whether those policies, procedures, and/or protocols are sufficient and compliant with applicable employment and other law, and, if there are deficiencies, the potential liability expense and cost, and general impact on operations, of addressing those deficiencies.

(iii) Extended Impact. Purchasers should also consider specifically inquiring about the current and expected impact of COVID-19 on key business relationships of the seller, including, for example, whether any communications have been made to or received from any materials customers, suppliers, vendors, distributors, or other key business relationships regarding COVID-19

(iv) Insurance. Purchasers should also consider whether the seller's existing insurance covers any potential losses the seller may experience as a result of COVID-19 and, if so, whether that coverage will remain in place post-closing.

(v) Representations & Warranties. Parties should consider whether additional representations and warranties or disclosures are needed in the purchase agreement to address the impact of COVID-19.

(vi) Inclusion of Specific Representations. Purchasers should consider whether any specific representations should be included that address the impact of COVID-19 on the hospitality asset, the policies, procedures, and protocols the seller currently has in place, and the sufficiency of the seller's current infrastructure to support such policies, procedures and protocols.

(vii) Allocation of Responsibility. The parties should ensure they understand the allocation of responsibility in the purchase agreement for, and the extent to which any rights against third parties (e.g., insurers) may offset, any losses the seller may incur arising from the spread of COVID-19.

e. Material Adverse Effect. Purchasers may seek protections through material adverse effect ("MAE" or "MAC") provisions and/or a corresponding closing condition that would permit them to terminate a PSA without liability to the seller in the event circumstances deteriorate further. Owners would be well-advised to resist such purchaser protections on account of the fact that the COVID-19 outbreak is a well-known risk affecting businesses generally. Accordingly, Owners 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 an MAE provision.

C. SPECIAL TYPES OF OWNERS FOR TAX PURPOSES.

1. REITs. If the purchaser is a REIT (or a partnership or limited liability company in which a REIT is a partner or member), in addition to meeting the general requirements for sources of income and assets applicable to REITs, the purchaser must lease the hospitality asset to a third-party operator. If leased to a taxable REIT subsidiary of the REIT, then the hospitality asset would have to be operated by an "eligible independent contractor" and the hospitality asset would have to qualify as a "qualified lodging facility." In addition, a 10% limitation applies with respect to rent attributable to personal property in the hospitality asset.

   a. Eligible Independent Contractor. An "eligible independent contractor" is any independent contractor that, at the time of execution of the HMA, is actively engaged in the trade or business of operating qualified lodging facilities for persons unrelated to the REIT.

   b. Qualified Lodging Facility. A "qualified lodging facility" is a hotel in which more than one-half of the dwelling units are used on a transient basis and that does not have wagering activities conducted by a person in the business of accepting wagers.

   c. Special Rule Under the CARES Act. Section 2303 of the CARES Act specifies that net operating losses (NOLs) incurred in 2018, 2019, and 2020 may be carried back five years and may be used to fully offset income for tax years up to December 31, 2020. However, NOLs for a REIT tax year may not be carried back, and non-REIT NOLs may not be carried back to REIT years.

2. Tax-Exempt Investors. If the purchaser is a tax-exempt Investor (or a partnership or limited liability company in which a tax-exempt Investor is a partner or member), to avoid recognizing Unrelated Business Taxable Income ("UBTI"), the purchaser must lease the hotel to a third-party operator or to a taxable C-corporation in which the tax-exempt Investors are shareholders. In addition, if the purchase is financed with debt, certain requirements will have to be satisfied to avoid UBTI under the debt-financed income rules.

D. SPECIAL CONCERNS REGARDING CONDO-HOTELS. If the purchaser is attempting to acquire a troubled condo-hotel, the purchaser will need a plan of action and should consider the following:

1. Convert Condo Units and Reposition the Hotel. If the condo-hotel has not been completed, or if a percentage of units remain unsold, it may make sense to temporarily or permanently convert

existing condominium units to hotel rooms, making the hotel potentially easier to sell and finance. In connection therewith, the purchaser should keep the following in mind:

a. Approval of Unit Owners. If any of the condominium units have been sold, any conversion will typically need the approval of some percentage of Unit Owners (e.g., a majority or supermajority of Unit Owners);

b. Concessions. To obtain the necessary approvals, a purchaser could offer Unit Owners concessions and amenities that would be enjoyed by Unit Owners (e.g., spa memberships and/or certain access rights) to help compensate for a Unit Owner's losses; and

c. Stopping Sales. The seller should stop selling unsold units and perhaps attempt to terminate break-up purchase contracts that have not closed (this will likely require the return of the deposits).

2. Communicate with All of the Stakeholders. To successfully convert the condominium units, and otherwise work out the troubled hospitality asset, the purchaser must communicate the proposed plan to all of the hospitality asset's stakeholders, including Unit Owners, the seller, lenders, operators, and employees.

E. SPECIAL CONCERNS REGARDING PROJECTS WITH PENDING CONSTRUCTION. The acquisition of a distressed hospitality asset with pending construction raises additional issues and concerns that should be investigated and addressed prior to acquisition. Further, due to the COVID-19 pandemic, certain jurisdictions have imposed "shelter-in-place" orders that affect whether pending construction can continue. In some states, all construction is considered "essential business" and may continue despite other shutdowns, while in other states construction has not be deemed an "essential business" unless it is for a specific use (e.g., affordable housing). In other states, construction is not permitted unless it relates to essential infrastructure. Whether pending construction is allowed to continue due to COVID-19 is a very dynamic situation and the rules are constantly changing. In addition to underwriting the work in place and the cost to complete, the purchaser needs to carefully review and analyze the following items as part of its acquisition plan for a distressed hospitality asset:

1. Will the Purchaser Be Completing Construction with the Existing Architect and Contractor?

a. New Architect and/or Contractor. If not, underwriting the cost and timing of completion and warranty and defect risk becomes far more complex, particularly given the new COVID-19 concerns noted above. The risk of mechanics' and materialmen's liens will increase significantly, and to the extent possible, the purchaser will need to ensure it negotiates for appropriate protections, such as indemnities and holdbacks, to cover such risk. The purchaser should have existing insurance and bonds reviewed by the appropriate experts. To the extent that the underlying contractor and subcontractor team do not substantially finish the original construction, bonds and completed operations insurance coverage can be significantly undermined. Sometimes completed operations coverage can be substantially replaced, but the terms of such coverage need to be carefully negotiated to remove preexisting work and other standard exclusions that can substantially vitiate the coverage. Replacing an architect during the construction of the project is typically difficult and expensive, and can lead to significant project delays. Any such approach should only be taken after a careful legal review of the architect's contract, particularly with respect to the prior architect's intellectual property rights in its work product and indemnities relating thereto. Many architects are unwilling to act as a replacement architect of record, and those that do are reluctant to rely upon the work of a prior architect. The replacement architect is likely to do fairly extensive redundant work to confirm the drawings and calculations of the prior architect, and will frequently negotiate substantially diminished warranties regarding its work. In this regard, Owner may be able to deliver "as built" drawings upon completion, since the new architect may be reluctant to certify what is behind completed interior walls.

b. Same Contractor and/or Architect. If the purchaser intends to proceed with the same architect and contracting team, care should be taken to understand the status and terms of the contracts being assumed and the terms and conditions of such assumption. Typically, the purchaser will want to negotiate a tri-party assumption and amendment to the construction contract to clarify the terms and conditions for the transition of the project to the purchaser's control, appropriately delineate the respective liabilities of the seller and the purchaser and document any representations and warranties, concessions and acknowledgements negotiated with the contractor.

2. Mechanics' Lien Protections. The purchaser will want to protect itself from post-closing exposure to mechanics' and materialmen's liens to the extent possible. Traditionally, the purchaser of a project with pending or recently completed projects could frequently procure title insurance, with mechanics' lien coverage and a waiver of the creditors' rights exception, to provide protection against mechanics' liens arising out of pre-closing construction work. Until recently, the endorsements were given with limited underwriting and scrutiny. The title company would require the seller or one of its affiliates to provide financials and to execute an affidavit and indemnity in favor of the title company, covering potential mechanics' lien claims. The title company might also review the status of lien releases for the project, but the endorsements were otherwise issued fairly routinely. With the effects of COVID-19 coming to fruition, title companies will experience significant mechanics' lien claims and losses due to market downturns, the underwriting process for mechanics' lien coverage will become increasingly more stringent, and many distressed Owners may not be able to procure such coverage. If title insurance coverage is not available, the purchaser's due diligence with respect to contractor and subcontractor payments and conditional lien releases becomes more critical, and purchasers may need to resort to other protections such as indemnities, holdbacks, standby letters of credit or other forms of security to protect against potential post-closing claims.

3. Purchase Agreement Terms. The purchaser will want to ensure that the purchase documents contain appropriate terms and conditions related to any pending construction project, including the following key terms:

a. Access and Diligence Rights. Rights for the purchaser or its consultant to review architectural, engineering and construction contracts; supervise and inspect work in progress and construction records, including applications for payment, change order logs, RFIs, construction meeting minutes and review and investigate any contractor or subcontractor claims.

b. Covenants Pending Closing. Owner commitments to proceed with construction in the ordinary course pending closing and to provide the purchaser with status reports and copies of applications for payment and material correspondence, particularly where delays will be experienced due to regulations related to COVID-19. Purchasers may also negotiate for the right to approve any material changes or deviations, such as change orders, and any modifications or settlements that could impact the obligations or the warranties and other rights to be assigned to the purchaser at closing.

c. Representations and Warranties. Since the purchaser will be acquiring a partially completed project, it will typically require the seller to provide representations and warranties regarding the status of the project; any pending or anticipated claims or disputes; the contracts, permits and other rights to be assigned to the purchaser in connection with the project and the seller's rights to assign its interest under such agreements and rights and the diligence information provided by the seller to the purchaser.

d. Conditions to Closing. The purchaser should consider and negotiate appropriate conditions to closing with respect to the construction project. Conditions to closing might include (i) the seller's maintenance of all construction entitlements and permits, (ii) obtaining required consents to assignment and modifications of project contracts, (iii) the occurrence of no material project delays, particularly with respect to any project delays due to the COVID-19 related concerns noted above, and (iv) the occurrence of no contractor or subcontractor claims or other material adverse changes in the construction project.

e. Assignments. The purchaser will want to ensure that all necessary contracts, permits and rights necessary to complete the project have been properly assigned to the purchaser and that the obligations assumed by the purchaser pursuant to such assignments are consistent with the business deal negotiated by the purchaser.

4. Insurance, Bonds and Warranties. The purchaser will need to determine whether insurance programs and bonds can be transitioned or will need to be replaced. It is prudent for purchasers to utilize insurance brokers or experts that have specific expertise with respect to construction-related insurance and bonds, particularly if the project involves wrap insurance such as Owner-controlled insurance programs or contractor controlled insurance programs. A careful review and transition plan for warranty and completed operations insurance coverage can also maximize coverage for construction defect risk and significantly reduce the costs of such coverage.

VI. WORKING WITH LABOR: CAN'T LIVE WITH THEM; CAN'T LIVE WITHOUT THEM!

A. GENERALLY. Labor matters play a larger role in the successful restructuring and/or purchase of a distressed hospitality asset than anything else, other than perhaps the capital stack. The labor force required to operate a hospitality asset (or skeleton crews operating hospitality assets in the wake of COVID-19) is an absolute necessity; however, assuming an existing group of employees and all of the prior owner's obligations and liabilities owing thereto can be an altogether new set of problems. Among other things, a purchaser should consider the following:

1. Pending and/or Threatened Litigation and Other Claims. Whether judicial, administrative, arbitral or otherwise, labor and employment claims can easily represent six- or seven-figure exposure. Such claims, and considerations relating to those claims, must be identified and taken into account in the deal pricing as well as in other pivotal deal provisions, such as representations and warranties, holdbacks, and indemnification. For example, the California Supreme Court recently ruled that employees who settle their individual Labor Code claims do not lose standing to pursue a claim for civil penalties under the California Labor Code Private Attorneys General Act of 2004 ("PAGA"), Cal. Lab. Code § 2698 et seq., based on the same alleged violations.

2. Compliance with Applicable Labor and Employment Law. Assessing overall compliance with applicable federal and state labor and employment law lest latent or potential claims go undetected and arise after the transaction closes, leaving the purchaser of the distressed hospitality asset with significant unanticipated liability or an unanticipated lack of flexibility. Indeed, when a hospitality asset is in distress, one of the casualties of cost- and corner-cutting is often legal compliance.

   a. Latent Exposures. Among the significant areas in which such latent exposure often lurks are the following:

      (i) Wage and hour claims, such as claims with respect to overtime, meal and rest periods, wage deductions, gratuities, and off-the-clock work, are extremely common in the hospitality industry. These claims can be brought as single or collective actions. The rules in this area are complicated and ensuring compliance requires a level of attention often not typical of, or even deemed practical, in a distressed hospitality asset operation, or in a situation such as the current COVID-19 pandemic, where employment matters have become ever more prevalent. Even to the extent that a purchaser can shield itself from pre-closing liabilities, it is critical to assess pre-closing practices to ensure that the purchaser does not fall into the trap of continuing the seller's mistakes.

(ii) Discrimination claims encompass discrimination and harassment on the basis of a myriad of protected categories including, but not limited to, sex, gender, race, national origin, religion, age, citizenship and disability, all seen in the hospitality industry. Again, these claims can be brought on an individual or a class basis and can serve as a potential impediment to making cost-cutting staffing and related changes.

(iii) Employee benefits claims are extremely complex and require expertise all too often lacking in the context of a distressed hospitality asset. Given the systemic nature of violations in this area and the potential cost of correction, exposure can be broad-based and significant. It is critically important that purchasers understand that special easier-to-satisfy successor liability rules often apply to hold asset purchasers liable for the seller's employee benefit debts when mapping out an employee benefits due diligence strategy.

(iv) Immigration issues can be avoided simply by verifying an employee's legal right to work in the United States.

(v) The purpose of the WARN Act is to provide "protection to workers, their families and communities by requiring employers to provide notification 60 calendar days in advance of plant closings and mass layoffs. Advance notice provides workers and their families some transition time to adjust to the prospective loss of employment, to seek and obtain alternative jobs and, if necessary, to enter skill training or retraining that will allow these workers to successfully compete in the job market." 20 C.F.R. § 639.1(a). Numerous states and municipalities also have workplace closing laws, which are often more onerous than the federal WARN Act. There are two major reasons as to why purchasers need to be aware of the WARN Act's requirements: (i) purchasers may be held liable for failing to hire enough of the seller's employees and (ii) in distressed hospitality asset purchases the timetable is often tight, which makes early recognition of and addressing WARN Act requirements all the more imperative.

(vi) Violations of workplace safety laws can result not only in fines and other direct financial liability but, if serious enough, can result in the total shutdown of the hospitality asset with a commensurate diminution in hard-earned goodwill.

(vii) Labor relations govern the relationship between employers and the labor organizations that represent employees (i.e., unions). In many areas of the country, the hospitality industry is highly dependent upon unionized labor. Accordingly, it is paramount that the purchaser obtain a thorough understanding of the management-labor dynamic at the hospitality asset. Depending on how the deal is structured, the purchaser, through its manager/employer of employees, may have to assume any applicable CBAs and/or recognize and bargain with unions representing the employees. In addition, the purchaser should get a detailed understanding of any industrial disputes (i.e., strikes, lockouts or slowdowns) that have occurred and the issues that caused such disputes. The purchaser should also discern whether there are any outstanding unfair labor practice charges or pending arbitrations and the facts underlying such charges.

b. CBAs. As a fundamental aspect of due diligence, the purchaser must obtain copies of and carefully analyze the terms of any applicable CBAs and side letters. Among the questions the purchaser must answer are:

(i) Is the purchaser obligated by contract or otherwise to assume and/or recognize and bargain with the union(s) representing the seller's employees?

(ii) Is the purchaser obligated by contract or otherwise to hire all of the predecessor's employees?

(iii) Will the purchaser be allowed to set initial terms and conditions of employment?

(iv) What notice, if any, is required to be given to the union(s)?

(v) Are there any provisions in the CBA that, if not complied with, may enable the union to get an injunction to block the sale?

(vi) Can the purchaser effectively and economically operate under the terms of these agreements, or will it be necessary to attempt to modify them?

c. Pension and Welfare Benefit Plans. As noted above, compliance in this area requires special expertise. A federal law, ERISA, imposes many complex documentary, disclosure and other requirements with respect to both employee retirement plans (e.g., 401(k)) and welfare plans (e.g., health). Failure to comply with ERISA and the tax code can lead to significant liability. And, to the extent there are multi-employer retirement plans in effect, the purchaser should not agree to step into the shoes of the seller without a comprehensive understanding of the risk of withdrawal liability and the increased funding obligations it will be acquiring.

d. Other Benefit Plans. The purchaser should identify all plans in effect, and examine the plan terms, the costs of maintaining the plans and the procedures for/limitations on the right to terminate the plans.

e. Individual Employment Contracts and Golden Parachute Agreements. If retaining the existing executive workforce is a consideration, it is important that the purchaser understand the seller's existing contractual obligations so that it can effectively entice the executives to continue working at the property and negotiate new contract terms with them. If, as is often the case, the purchaser simply assumes existing executive employment agreements, a thorough review of those agreements is all the more important. This is especially the case in light of concerns with COVID-19 and employees at the workplace, recent case law and regulatory changes that significantly increase the purchaser's potential exposure.

f. Personnel Policies, Procedures, Handbooks, and Employment Practices Generally. These items comprise a critical element of employment law compliance and accordingly should be reviewed in attempting to identify latent and overt exposures as noted above. Due diligence is key for the purchaser to avoid continuing what may be the seller's less-than-best practices.

g. Staffing Retention, Augmentation and/or Right-Sizing Considerations. In order to get the distressed property up and running, the purchaser may wish to pay stay bonuses to ensure that key personnel remain, at least during transition. To the extent the purchaser has the flexibility to hire new employees, perhaps in an effort to upgrade its workforce, the purchaser should have in place appropriate application, screening, interviewing and hiring practices. And, as noted above, to the extent a reduction in force is contemplated, which has recently become the norm with COVID-19, rendering many hospitality assets closed or operating with skeleton crews, careful attention must be paid to such items as advance notice requirements, layoff provisions in applicable CBAs, discrimination and other applicable laws and severance obligations. In sum, before closing the transaction, the purchaser must attempt to anticipate what staffing modifications it contemplates making and ascertain whether contractual and other legal restrictions will permit the purchaser to make these modifications.

h. Joint Employer Issues. It is common in the hospitality industry to have employees of the Owner and employees of the Manager working side by side. This may create joint employer issues should the Owner decide to sell the hospitality asset. In order to understand where joint employer issues are likely to arise and to ascertain whether there will be any potential joint employer liability, before closing the transaction, the purchaser must understand: (i) the interrelationship between the Owner's employees and the Manager's employees, (ii) whether the Owner has control over the terms and conditions of the Manager's employees and vice versa and (iii) whether there are any indemnity provisions in the HMA addressing joint employer issues.

VII. ACQUIRING DISTRESSED DEBT: INVESTING SENSE ON THE DOLLAR

A. "LOAN-TO-OWN" — ACQUIRING THE DEBT. In the anticipated economic downturn due to the aftermath of COVID-19, purchasers may find it makes more sense to acquire a hospitality asset by purchasing its debt. However, the debt markets may spawn capital structures that can represent both opportunities and challenges. In past down cycles, purchasers of hospitality asset debt have typically acquired a single mortgage loan. However, for this upcoming cycle, purchasers have a variety of complicated choices. Understanding the following choices and the legal and financial implications of each is the key to purchasing hotel debt in this cycle:

1. Due Diligence. The purchaser of a loan secured by a distressed hospitality asset must perform adequate due diligence to assess the rights and risks of its target acquisition. In the case of acquiring the debt, the purchaser must analyze (i) the hospitality asset (and all aspects of the hotel business and operations, as noted above); (ii) the credit worthiness and operational experience of the borrower (including its constituent members, if additional capital requirements exist under the joint venture agreement and/or the HMA or existing construction contracts) and guarantors; (iii) the subject loan documents; (iv) the lending relationships among all other lenders in the capital stack and (v) operational and development (to the extent applicable) transaction issues (which may be exacerbated in the event a foreclosure creates an adversarial relationship with the borrower and/or existing contractors, consultants and other critical project participants). As mentioned earlier, please keep in mind that the COVID-19 pandemic may affect the ability and timeframe of the due diligence process. In addition, when acquiring debt secured by a distressed hospitality asset, a purchaser must understand the following:

    a. Financial Underwriting. The purchaser must analyze, among other things, the borrower's financial statements, hospitality asset income and expense projections, current and anticipated debt service coverage ratios, the current value of the hospitality asset and its loan-to-value ratio (as noted earlier, in the anticipated decline in real estate market, it is very difficult to value distressed hospitality assets), existing reserve balances (interest reserves, FF&E reserves and capital reserves) and other financial indicators.

(i) Maximizing Addbacks to EBITDA. Prior to March 10, 2020, there had been success negotiating specific addbacks to EBITDA for COVID-19 related events. Now, there is an expectation that any requests for specific addbacks related to COVID-19 will receive heightened scrutiny from agents and lenders. Indeed, there is an understanding that certain lenders are not permitting their deal teams to approve any COVID-19 addbacks without the further internal approvals. Borrowers should carefully examine their existing addbacks to determine whether there is any flexibility to addback COVID-19 impact.

(a) Proceeds of Business Interruption Insurance. First, consult with an insurance broker to understand the policy scope of coverage. It may require "actual" property "damage." Inquire whether there is "civil authority" coverage, in the event of a shelter-in-place mandate. Also, confirm whether the policy includes "contingent business interruption" coverage (i.e., coverage relating to, among other things, supply chain disruptions). Healthcare and hospitality borrowers are more likely to include pandemic coverage in general business interruption coverage. Second, consider whether it is forwarding-looking or requires actual receipt of proceeds (i.e., "*….to the extent not included in the calculation of net income (or loss) for such period, **proceeds of business interruption insurance whether or not yet received**, so long as the Borrowers expect in good faith to receive such proceeds in cash within the subsequent period of four (4) Fiscal Quarters (it being understood that to the extent any such amounts are not actually received within such subsequent four (4) Fiscal Quarter period, such amounts shall be deducted in calculating EBITDA for such subsequent measurement period) received in cash during such measurement period…*"; "*…proceeds from business interruption insurance **received in such period** in an amount representing the earnings for such period that such proceeds are intended to replace (to the extent not reflected as revenue or income in such Consolidated Net Income)…").*

(b) Proceeds of Reimbursements, Indemnitees or Other Insurance. Borrowers should consult with their insurance brokers to confirm the possibility of any other potential insurance recoveries (e.g., event cancellation insurance, in hospitality industry). Borrowers should also confirm whether any costs, losses or expenses may be indemnified by a third party or are reimbursable. In addition, borrowers should confirm whether it is forwarding-looking or requires actual receipt of proceeds (i.e., "*….charges, losses or expenses to the extent indemnified, reimbursed or insured (or which are reimbursable, indemnifiable, or insured) by a Person that does not constitute an Affiliate of Holdings or its Subsidiaries; provided that the Borrowers in good faith **expect to receive reimbursement for such charges, losses and expenses within the next four (4) fiscal quarters** (it being understood that to the extent not actually received within such fiscal quarters, such reimbursement amounts shall be deducted in calculating Consolidated EBITDA for such fiscal quarters)….*").

(c) Litigation Expenses. Borrowers may be facing increased litigation risk as borrowers make decisions regarding stretching payables, enforcing vendor contracts, and seeking concessions from landlords. Borrowers may be able to rely on general litigation expense addbacks, to the extent incurring, among other things, legal expenses in connection with evaluating risk and strategy (i.e., "*…. any litigation charges and expenses not to exceed $[___] (or, with the consent of the Agent, any charges and expenses greater than $[___]); provided, however, that the consent of the Required Lenders shall be required* *for all requested additions in excess of $[___] during such measurement period….*”).

(d) Impact of Foreign Currency Exchanges and Hedging. Borrowers may have flexibility to addback losses from foreign currency translation (i.e., “*….cash losses or expenses (net of cash income or gains) from foreign currency transaction losses resulting from receivables, payables and other balances denominated in a currency other than a Loan Party or its Subsidiaries' functional currency in an aggregate amount not to exceed $[______] during such period…*”; “*…. unrealized or realized net foreign currency translation or transaction losses impacting net income (including, without limitation currency re-measurements of Indebtedness and any net gains or losses resulting from hedge agreements for currency exchange risk associated with the above or any other currency related risk)….*”).

(e) One-Time Compensation Expenses. Borrowers should consider whether any expenses arising under new Congressional mandates may be added back pursuant to a compensation related addback. Costs and expenses may be added back by borrowers in light of remote work mandates, furloughs, lay-offs and other unusual events. Borrowers should consider descriptions of any compensation payments (i.e., “*…..non-recurring costs and expenses incurred in connection with the recruitment and relocation of employees of the Borrowers and severance costs and expenses of the borrowers (including restructuring charges, retention, recruiting, relocation, moving expenses, signing bonuses and expenses, search charges and expenses, third party assessments of candidates, stay bonuses paid to existing management, stock option and other equity-based compensation expenses, accruals or reserves)….*”).

(f) Non-Recurring, One-Time or Unusual Charges or Expenses. Borrowers should heavily scrutinize their non-recurring cost and expense addback in order to addback COVID-19 impact (i.e., “*…..any extraordinary, unusual or non-recurring expenses, losses or Charges incurred or any one time or single event expense (including restructuring charges, retention, recruiting, relocation, moving expenses, signing bonuses and expenses, search charges and expenses, third party assessments of candidates, stay bonuses paid to existing management, stock option and other equity-based compensation expenses, accruals or reserves) (“**Non-Recurring Expenses**”); provided, however, that the aggregate amount of Severance and Restructuring Costs, Cost Savings (as defined below), Actual Cost Savings (as defined below), and Non-Recurring Expenses added back ….. shall not exceed the greater of $[___] and [____] of Consolidated EBITDA… in the aggregate for any measurement period…*”).

(g) Business Optimization. Some credit agreements will allow borrowers to addback run rate cost savings and other synergies in connection with COVID-19 restructuring matters. Such addbacks usually have multi-prong requirements, including requirements that such cost savings are expected to be realized within twelve months (i.e., “*…the amount of “run rate” cost savings, operating expense reductions and synergies related to acquisitions, dispositions, restructurings, sales, transfers, investments, cost savings initiatives and other initiatives (all such items, “Post-Closing Cost Savings and Synergies” and together with the Transaction Cost Savings and Synergies,* *"Cost Savings and Synergies") that are reasonably identifiable, factually supportable and projected by the parent borrower in good faith to result from actions that have been taken or with respect to which substantial steps have been taken, in each case, within twelve (12) months after such acquisition, disposition, restructuring, sale, transfer, investment, cost savings initiative or other initiative (which will be added to Consolidated EBITDA as so projected and calculated on a pro forma basis as though such cost savings, operating expense reductions and synergies had been realized on the first (1st) day of such period), net of the amount of actual benefits realized during such period from such actions….*").

(h) Lost Profits. General lost profit addbacks are unusual in EBITDA definitions. It is more likely than not that borrowers would need to request an addback for lost profits attributable to COVID-19 impact, instead of relying on an existing addback. If lost profits are added back to EBITDA in an existing credit agreement, it is generally in the context of a specific one-time situation. For example, a borrower's manufacturing plant was destroyed by a tornado and Lenders agree to permit the borrower to addback lost profits attributable to the tornado impact.

(i) Other Considerations. Many EBITDA definitions will cap (via hard dollar, a percentage of EBITDA or a combination of both) the overall amount of non-recurring and cost savings addbacks. Adding back proceeds of business interruption or other insurance may increase a borrower's excess cash flow payment, if it was not specifically backed out from an Excess Cash Flow calculation that "starts" from EBITDA.

(ii) Managing Cash Netting. For purposes of calculating the leverage covenant, "Total Debt" will include, among other things, all debt for borrowed money, including revolving loan borrowings. Many credit agreements allow borrowers to net unrestricted cash on hand against the amount of "Total Debt" (in lieu of requiring Borrowers to prepay debt). Most middle market credit agreements will cap the amount of "nettable" unrestricted cash on hand and require that "nettable" cash be in deposit accounts subject to a control agreement. In addition, borrowers should confirm if borrowers can receive any credit for any cash held in a deposit account of a non-U.S. subsidiary or credit party. Many borrowers borrowed a substantial portion of their revolving loan capacity in early to mid-March. Unless repaid on or before March 31, 2020, those borrowings will increase "Total Debt" as of March 31, 2020. Borrowers should consider whether to repay the revolving loans in excess of the "nettable" cash on March 31, 2020 and evaluate whether to re-borrow in April.

(iii) Deferring Recurring or Fixed Charges. For those borrowers subject to a Fixed Charge Coverage Ratio or Interest Coverage Ratio test, Borrowers should consider implementing strategies to reduce recurring or fixed charges. Consider whether to finance capital expenditure projects (i.e., burden the denominator of most calculations versus the numerator). In regards to management fees, Sponsors may want to consider deferring paying management fees in cash. Sponsors and borrowers should confirm when such fees could be paid in the future. Regarding extending interest payment dates, most credit agreements will permit borrowers to elect to incur interest at the prime rate or LIBOR rate plus a margin. If borrowers anticipate holding Revolving Loans for an extended period of time, borrowers should convert their Revolving Loans to LIBOR Loans in order to realize some cash interest savings. Borrowers may elect to convert or continue their Loans in at least three-month LIBOR, since most credit agreements will only require borrowers to pay interest at the end of each 3-month LIBOR period. Prime or base rate interest may be due monthly. Simply not paying in cash some components may not result in a benefit (i.e., "*….Fixed Charge Coverage Ratio means, for any Computation Period, the ratio of (a) the total EBITDA for such period of holdings and its subsidiaries minus the sum, without duplication, of (i) all income taxes and tax distributions described in Section 7.4 (including Permitted Tax Distributions) to the equity holders of Holdings* ***paid or payable in cash*** *by holdings and its subsidiaries for such period, plus (ii) all Unfinanced Capital Expenditures (other than Transition Capital Expenditures) paid in cash of holdings and its subsidiaries for such period, plus (iii) management fees paid in cash to sponsor and its affiliates for such period, to (b) the sum for such period of (i) Interest Expense accrued* ***and paid or payable in cash*** *during such Computation Period by holdings and its subsidiaries (excluding in all instances any interest paid in kind and any closing fees or amendment fees paid on the Closing Date and in connection with any amendments), plus (ii)* ***scheduled payments (which scheduled payments, for the avoidance of doubt, shall not include any mandatory prepayment required pursuant to Section 2.10.2(a)(iii)) of principal of Debt (excluding Revolving Loans)*** *of Holdings and its Subsidiaries…...*"). In addition, some credit agreements require borrowers to keep their accounts payable current and discharge obligations when due (i.e., "*…. Pay and discharge promptly (i) when due all material taxes, assessments and governmental charges or levies imposed upon them or upon their income or profits or in respect of their properties before the same shall become delinquent or in default and (ii) within 60 days of the due date thereof, all lawful claims for labor, materials and supplies or otherwise, other than amounts in the aggregate of $[_____] or less, which, if unpaid, might give rise to liens or charges upon such properties or any part thereof; provided, however, that the loan parties and their subsidiaries shall not be required to pay and discharge or to cause to be paid and discharged any such tax, assessment, charge, levy or claim so long as the validity or amount thereof shall be contested in good faith by appropriate proceedings and the loan parties and their subsidiaries shall have set aside on their books adequate reserves with respect thereto….*").

(iv) Navigating the "Gray Area." As of March 31, 2020, agents and lenders may deny a draw request if there is certainty that a breach of a financial covenant occurred as of March 31, 2020, notwithstanding that no certificates have been delivered. Between March 31, 2020 and May 15, 2020, agents and lenders will scrutinize whether a default *may* have occurred. During this "gray area," borrowers should be prepared to demonstrate to agents and lenders that the borrowers will pass any covenant tests. If a borrower is certain that it will not pass a financial covenant test, during the "gray area," it is more likely than not that borrowing on the revolver constitutes another default. It is especially critical for distressed Borrowers to consider borrowing needs/liquidity *well in advance* of March 31 (or next covenant testing/payment date).

(v) Reviewing Event of Default Cure Periods. Borrowers should endeavor to timely deliver their reporting packages. Some borrowers will be in immediate default for failing to timely deliver their reporting packages. Other borrowers may have a short cure period (e.g., two or three Business Days) to fix the untimely delivery. If borrowers anticipate a delay, borrowers should request an extension of the delivery deadline in advance. This is almost certainly a required lender (vs. all lender) approval. While agents/lenders typically do not enforce remedies on the basis of late financial deliveries, agents/lenders could decline to fund a revolving loan request on the basis of the default. In addition, any "event of default/default" qualified exception to the negative covenants is no longer available to borrowers (and would negate any equity cure benefits) and, if pricing is tied to a grid, pricing may increase to the highest level during an event of default. Finally, the loans may incur default interest (either automatically or upon a vote of the required lenders).

(vi) Exercising Equity Cure Rights. Many sponsor-backed credit agreements give sponsors the ability to "cure" a financial covenant breach by contributing debt or equity proceeds into a borrower. Equity cure mechanisms in credit agreements vary, but generally require that sponsors make the contribution within ten to twenty business days from the date upon which the borrower was required to deliver the applicable compliance certificate. Sponsors should confirm whether the amount of the equity cure is capped or if the cure amount may be "topped off." In this environment, sponsors should confirm whether consecutive cures may be permitted and if the sponsor is capped at an overall amount of cure. For borrowers with "split" or "shared" collateral or first/second lien credit facilities, special attention should be given to how the equity cure rights work as between the facilities. An ABL credit agreement may only have an availability cure while the term loan credit agreement has an EBITDA-based cure. Sponsors likely do not want to be in a situation where they are required to cure each separately. Sponsors should not exercise equity cures if there are other existing events of default, as the equity cure right likely solely cures breaches of the financial covenant default(s). Late delivery of financials is not cured through an equity cure. Sponsors should be mindful of the impact of cross-defaults to other debt instruments or material contracts. Sponsors may also wish to avoid contributing additional debt or equity into a borrower. Instead, Sponsors may decide to negotiate directly with agents and lenders to waive the default.

b. Negotiating Forbearance, Waivers and Other Mitigation Tools. Borrowers can begin to formulate requests now in the event that borrowers will seek an amendment, waiver or forbearance, after a default. Areas to consider are: (1) EBITDA (specified COVID-19 addback for costs, expenses or lost profits; specified addback for any landlord concessions (or cash basis, in EBITDAR); increase or holiday from existing EBITDA addback caps; stipulate TTM EBITDA or build/annualize 1Q of EBITDA after "return to normalcy"; (2) increases to cash flow (pay a portion of, or all, interest in kind; amortization holidays; waiver of any mandatory prepayments, in particular, excess cash flow; pay down of revolver (vs. term loan) from equity cure proceeds (or waiver in entirety); permit incurrence of sponsor debt on a subordinated/second silent lien basis; permit incurrence of government "emergency" secured loans); (3) covenant re-set, covenant holidays and covenant swaps. Borrowers should be mindful of whether proposed requested relief requires all Lenders or only required lenders. Agents and lenders may request any of the following (and more) in connection with these negotiations: impose default interest; charge amendment, waiver and forbearance fees; increase pricing, including imposition of LIBOR floors; require cash collateral for undrawn letters of credit; demand sponsor/parent guaranties and other sponsor/parent-backed credit support; conduct collateral reviews; renegotiate exercise of remedies, including mechanics to exercise voting rights; increase number of financial covenant step-downs (or step-ups, if applicable) or imposition of other financial covenants, including liquidity covenant. In some situations, the Agent and Lenders may engage a third-party financial advisor and/or transition the credit to a work-out group. Borrowers are well-served to develop a strategy now and we are well-positioned to advise on current market trends and behaviors.

c. Capital Stack. Hospitality assets have come to secure capital structures that include the traditional single mortgage loan (which may be packaged with other loans as a type of commercial mortgage-backed security ("CMBS")) as well as mezzanine loans and/or other subordinated financing. Consequently, purchasers may have the option to purchase (i) the first priority mortgage loan, (ii) a mezzanine loan, (iii) a subordinated note, or (iv) a participatory interest in the mortgage loan (without a direct contractual connection to the borrowing Owner). If the mortgage loan is in distress (oftentimes defined to mean 60 days past due and/or the inability of borrower to meet material performance criteria), purchasers may think it makes the most sense to purchase the defaulted loan at a negotiated reduction to the outstanding principal loan amount and to foreclose on the property to obtain title to the hospitality asset. However, this "loan-to-own" strategy will be impacted by the Manager's approval rights and the contractual relationship between lenders in the capital stack.

d. Property Due Diligence. Since there is no privity of contract (i.e., property purchase agreement) between the owner of the hospitality asset and the debt purchaser, a debt purchaser's rights to perform physical due diligence will be limited to the rights of access the selling lender may have as set forth in the loan documents being purchased. Consequently, the purchaser may have limited rights to perform physical due diligence (especially if acquiring a mezzanine loan or subordinated piece). Therefore, the purchaser must have access to all of the selling lender's physical reports, including physical inspection reports, appraisals, environmental reports, title and survey and access generally to the lender's files.

e. Loan Due Diligence. In addition, a purchaser of hospitality asset debt must conduct due diligence on the subject loan documents to confirm standard operating covenants, insurance requirements, transfer restrictions, any subsequent funding and disbursement requirements, defaults, and remedies. Because foreclosure upon the distressed asset (or borrower, in the case of a mezzanine loan acquisition) is the ultimate goal, purchasers must confirm the adequacy of the security documents (mortgage, UCC-1, pledge and security agreements, guaranties) and perform due diligence on the rights and obligations under any intercreditor agreements (discussed below). The purchaser must be sure that the collateral for the loan includes all relevant assets (for example, IP, relevant trade names and trademarks) to continue uninterrupted operation of the hotel business. Finally, confirm jurisdictional legal requirements — certain jurisdictions may have rules making it difficult to go after both real and personal property assets simultaneously.

f. Intercreditor Agreements. Intercreditor agreements ("ICA") define the rights and obligations of and between the creditors in the capital stack, including: (i) the rights and protections granted to mezzanine lenders, and the conditions and restrictions imposed on a mezzanine lender's ability to enforce its loan documents and (ii) the mezzanine lender's ability (or lack thereof) to modify its loan documents. As a corollary to the ICA, Recognition Agreements are agreements between senior secured lenders (mortgage and mezzanine), on the one hand, and preferred equity ("PE") providers, on the other hand, that define and describe the rights and remedies available to the PE provider.

g. Construction Due Diligence. If the loan is a construction loan or a loan secured by a project with pending construction, the purchaser should conduct a thorough diligence review of the status of the construction project; the construction contracts and rights assigned to the lender as security for the loan; the status of the construction budget and schedule (also considering any COVID-19 implications); the status of loan draws and lien releases; the insurance and bonding in place for the project and the lender's rights with respect thereto and any future funding obligations that may be assumed by or asserted against the purchaser.

B. MEZZANINE LENDER'S RIGHTS. It is also important to understand the mezzanine lender's rights (i.e., notice and cure rights, mortgage and/or loan purchase rights) upon a default under the mortgage loan. This is important not only to ascertain the mezzanine lender's ability, if any, to delay a mortgage lender's foreclosure action, but also to determine the time and place that the mezzanine lenders can commence foreclosure. It is interesting to note that unlike many state laws that give the borrower the right to cure current payment defaults well past notice and cure periods (and often, particularly in connection with nonjudicial foreclosures, as late as a few days before the actual date of sale), most state laws provide that once the borrower has defaulted beyond any contractual notice and cure periods under any loan secured by a pledge of membership interests in a limited liability company, it is forced to pay off the entire amount of the debt (as opposed to simply cure the current payment default) in order to prevent the foreclosure from taking place (something borrowers must weigh very carefully before failing to make loan payments as, for example, a part of its strategy to force the lender(s) to negotiate).

VIII. EVENTS OF DEFAULT, CLOSURES, AND FORCE MAJEURE

A. <u>FORCE MAJEURE</u>.

Businesses should review with counsel the terms of any existing contracts that may be impacted by COVID-19, especially those that call for the delivery of goods and/or rely on adjustable pricing mechanisms. 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.

In general, force majeure provisions excuse parties from nonperformance when an “act of God” makes performance impossible, impractical, or illegal. 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, and not be caused by a party’s own fault or negligence.

Common examples of force majeure events include natural disasters, political acts, or terrorism. When an intervening act occurs, the party invoking the force majeure clause as a defense for nonperformance bears the burden of proving that the event was actually beyond its control. Accordingly, a party invoking the force majeure provision in this environment would likely have to show that the specific contractual force majeure provision encompasses the COVID-19 epidemic (either specifically (e.g., “pandemic,” “epidemic,” or “infectious disease”) or generally (e.g., events outside of a party’s reasonable control)), that the contract could not be performed because of COVID-19, that COVID-19 was outside its control, and that it occurred without the asserting party’s fault or negligence.

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 in the context of lease contracts.

<u>Impossibility</u>. In cases where leases do not expressly include a force majeure clause, the common law doctrine of impossibility may be raised to excuse contractual performance. The doctrine of impossibility is where, “after a contract is made, a party’s performance is made impracticable without fault by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made, and duty to render that performance is discharged, unless the language or the circumstances [of the lease] indicate [otherwise].” Similar to the force majeure clause, the common law doctrine of impossibility is a factual determination that is narrowly construed. The courts will first look to the lease for guidance for

any terms or conditions that may limit the use of this doctrine, such as no abatement provisions. The courts may also look to the lease to see whether the purpose of the lease is able to be fulfilled, even though the unforeseeable event has occurred. It is important to note that in most cases, impossibility is difficult to prove. This is because the impossibility cannot merely be impractical or based on an unanticipated financial hardship. Courts may consider whether the party requesting relief from its nonperformance tried to mitigate the harm and whether additional time or resources would allow the party to fulfill its obligations.

Frustration. Another similar common law defense to excuse contractual performance that tenants may look to raise is the concept of frustration of purpose. The Second Restatement of Contracts § 265 provides that a party may discharge its performance where "a party's principal purpose is substantially frustrated without fault by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made."

Both the doctrine of impossibility and frustration of purpose rely on the foreseeability factor; that is, whether or not the event could have been addressed in the lease. Tenants may claim that COVID-19 was not foreseeable, but an argument can be made that the presence of similar pandemics, such as SARS or H1N1, renders the presence of COVID-19 reasonably foreseeable at the time of contracting. Similarly, the absence of a force majeure clause could be a fair argument against applying such theories to a contract since force majeure clauses are generally available for negotiation and the parties could have agreed to address the issues specifically. Although both doctrines depend on the specific terms of the lease analyzed against the associated facts presented by COVID-19, along with applicable laws, these doctrines offer another avenue that tenants may pursue in the event a force majeure clause is not expressly addressed in the lease.

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. These and other defenses should be carefully researched under the appropriate jurisdiction to determine whether there is a reasonable basis for their applicability. *See* PH COVID-19 Client Alert Series: Force Majeure and the Doctrine of Frustration in Light of COVID-19, March 19, 2020.

B. INCREASED PERFORMANCE COSTS AND PRICING CONCERNS.

Importantly, the mere occurrence of unfavorable economic conditions or market shifts may not qualify as force majeure or other events that excuse performance. In the same vein, difficulties in performance 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." An example of this principle in practice is found in *Transatlantic Financing Corp. v. United States.* In *Transatlantic*, the D.C. Circuit Court of Appeals affirmed a finding that there was no commercial impracticability where one party sought to recover damages because its wheat shipment was forced to be re-routed due to the closing of the Suez Canal. The Court of Appeals held that because the contract was not rendered legally impossible and it could be presumed that the shipping party accepted "some degree of abnormal risk," there was no basis for relief.

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. As a result, parties should examine their agreements to determine the increased cost impact from COVID-19 and, if the impact is significant, potentially discuss with their counterparties adjustments that can be made if the performance costs no longer reflect the intentions or expectations of the parties. In addition, 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.

C. NOTICE REQUIREMENTS.

All contractual notice provisions should be carefully scrutinized to determine whether COVID-19 triggers any notice requirements. For example, if a party invokes force majeure, the contract provision might require that they send notice within a set time period to the other party regarding the impossibility or impracticability of performance. Anticipated delays in shipments and payments may also contractually require advance written notice. Likewise, non-breaching parties may be obligated to provide written notice of breaches to their counterparties before cure periods start, termination rights are exercised, or damages rightfully are claimed. Even if notices are not contractually required, they may be advisable so that any counterparty is on notice to mitigate any potential damages and offer alternative methods of performance.

Caution should be exercised, however, to avoid inadvertently delivering a notice that anticipatorily breaches a contract. While varying by jurisdiction, anticipatory breach of contract is generally defined as “a repudiation of the obligations of a contract by a party to it before the time has come for performance on his or her part.” 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. Thus, any communications concerning difficulties or anticipated delays in performance should be carefully vetted so the communicating party avoids mistakenly suggesting that it does not intend to perform under the agreement.

D. CONTRACTUALLY ADDRESSING POTENTIAL FUTURE EFFECTS.

Disruption in financial markets in response to the spread of COVID-19 will certainly affect companies’ general business expectations as well as planned and proposed financings and investment operations. The New York Times recently reported that “as the coronavirus outbreak spreads, the world’s biggest companies have begun painting a bleak picture of broken supply chains, disrupted manufacturing, empty stores and flagging demand for their wares.” Indeed, the level of U.S. business activity for the month of February hit a six-year record low as companies reacted to predictions of a global economic slowdown. Reduced demand for consumer goods and energy consumption due to self-quarantine is expected to curb companies’ earnings and disrupt long-term financial projections. Additionally, companies may suffer investment challenges because investors may be less likely to extend loans and banks may begin to impose lending restrictions.

Looking forward, contractual provisions should be drafted with these potential effects in mind. Parties may wish to draft more expansive force majeure clauses to capture a wider array of natural and political acts that could arise from COVID-19 becoming a pandemic. In addition, parties might desire more flexibility with termination provisions through shorter notice periods and more lenient termination requirements. Pricing arrangements are yet another area where change may be necessary. Variable pricing provisions may be scrapped in favor of fixed prices or constrained with caps or mandatory renegotiation thresholds. Even choice of law and venue provisions, often lightly negotiated, will take on new importance and interest as parties consider which jurisdictions may be more receptive to certain contractual defenses and claims. In sum, parties will need to continuously monitor the impact COVID-19 has on their businesses and adjust their future contractual expectations and goals accordingly to mitigate risk and provide as much flexibility as possible.

E. OWNER CONSIDERATIONS IN DEFAULT. For purposes of this discussion, we assume that a valid default notice has been issued and there is no dispute as to the monetary default alleged by the lender.

1. Notice of Default. The notice of default must be examined for possible defenses; most significantly, it must be confirmed that the alleged default under the loan does not either (i) trigger in the Manager a cure right and time frame for cure or (ii) trigger a default or termination right under the FA or HMA.

2. Status of the Project. If the project is in some stage of construction or development, then determine the constellation of liabilities: any completion guarantor, if a construction loan; any recourse carve-out guaranty, if an operating facility and/or liabilities for payments received as key money or other incentives from the Manager or brand franchisor.

3. Review Loan Documents. No matter the level of distress, immediately review the loan documents to determine if the borrowers have any personal liability of any kind including, most importantly, whether a bankruptcy filing would create personal liability.

4. Communications.

   a. Investors. Owner communication with Investors and other ownership participants is essential through the default process. No Investor has been heard to complain: "We knew too much! We knew too early in the process!" or "We knew exactly how much and to whom and when we should pay to cure the default!"

      Lenders. In addition to any financial and progress reporting mandated by the various joint venture and other organizational documents, the Developer and/or the Owner is advised to maintain open lines of communication and, if available, participation by the Investor groups in the various lender meetings. Minority participation is always a judgment call that can play out in a variety of ways. Note that lenders have been inundated with requests for negotiations in connection with defaults or potential defaults under loan agreements due to the COVID-19 pandemic, so Owners should consider identifying the narrow scope of relief they need in any such request and to leverage any relationship they may have to make sure they stay at the top of a lender's queue.

5. Transparency. Owner inspections, meetings on and about property, and participation by and among all transaction principals, brand representatives, lender and mezzanine lenders, and senior mortgage lenders must be as transparent as practical.

6. Review Intercreditor Agreement. If possible, obtain a copy of the Intercreditor Agreement governing the relationships between senior mortgage lenders and mezzanine lenders, particularly with regard to negotiated processes dealing with consent rights, cure options, and control appraisal requirements.

F. LENDER CONSIDERATIONS AFTER DEFAULT.[5]

1. Generally. In cases where a default exists, the loan documents may require a formal written notice to borrower to convert a default into an "event of default," barring any applicable notice or cure periods. In most cases, only after a default has ripened into a full-blown event of default will the lender be entitled to accelerate the loan and demand payment in full of all outstanding amounts, effectively causing maturity of the loan. Note, such events of default may also trigger cross-defaults under financings of other lenders to the borrower and its affiliates. Following an event of default

[5] When we refer to "lender," we are referring to the senior mortgage lender unless the context suggests otherwise.

under a senior mortgage loan or mezzanine loan, any course of action by an owner or lender must take into account the type of ownership and operation of the hospitality asset. Hospitality assets can be single or "one-off" deals, or be included in large portfolio of transactions consisting of multiple properties with multiple levels of Investors and lenders.

2. Characteristics of Asset Operation. Three forms of property operation are common in today's marketplace: brand-franchised, brand-managed, and independent or "owner operated and branded" properties. In the context of each, the following is an analysis of the three forms of "property directed" remedies to resolve defaulted, distressed hospitality loans: receivership, deed in lieu, and foreclosure. In this discussion, we review these three frameworks with a new slant — as "rifle shot" remedies used to stabilize or reposition, and in some cases, to recreate the form of the asset itself. Here, a "brand-franchised" or "brand-managed property" is one affiliated by such agreements with a major hotel operator and franchisor, such as Hilton, Marriott or Hyatt, with extensive reservation, purchasing, and centralized services systems and accounting and financial reporting processes. An "owner-operated and branded property" is one that is owned and operated by an independent brand for its own account.

a. Forms of Asset Operations.

(i) In "brand-franchised" property, one should consider the following:

(a) A FA is a license agreement between a franchisor and a franchisee, granting a license to use specified intellectual property, brand marks, logos, trade names and usage rights in exchange for a flat fee. The franchisor owns and holds the exclusive rights to license such brand marks, logos or trade names. The fee for use is typically charged and collected on the amount of gross room revenues. Typically, revenues created at the facility from other sources (such as from food and beverage outlets, spas or amenities) are not included in the calculation of gross revenues for purposes of the franchise fee.

(b) The agreement may include certain rights to use national or global reservation systems and specified centralized services.

(c) Provisions requiring adherence to operating procedures, i.e., brand standards, are typical and failure to comply can result in termination of the FA.

(d) Employees are usually employees of either (i) the owner/operator or (ii) a third-party management company. In rare cases, the employees are employees of the franchisor.

(e) The franchisee may own or lease the real estate, buildings and improvements, and typically contracts for, or runs for its own account, the restaurants, food and beverage outlets, and spa or other luxury amenities. In circumstances where a third-party manager is engaged by the Owner or lessee of the real estate to manage operations, a separate HMA (and separate fee for services) is entered into by the franchisee and the management company, resulting in a "two-pronged" level of operations.

(f) Since the fees paid to the brand franchisor are based on the success (or lack thereof) of the owner/operator or manager/operator, termination of the brand-franchised arrangement does not rely on any performance tests (other than property condition) between the brand franchisor and the owner/operator.

(ii) In a "brand-managed" property, consider the following:

(a) Major brand management company agreements provide a "soup-to-nuts" turnkey operation and management of the hospitality asset pursuant to a comprehensive HMA. Owner cedes possession and control of operations to the Manager, retaining limited approval rights on budget matters, new programs and brand upgrades. This management model encompasses day-to-day operations coupled with strategic management of the hotel asset for the duration of the agreement term.

(b) Domestically, virtually all employees involved in the operation are the employees of the Manager.

(c) The HMA directs the Manager to maintain brand standards at the Owner's sole cost and expense.

(d) The fee structure consists of a base fee and incentive management fee subject to a negotiated waterfall for payments within the HMA. "Owner's Priority" or the amount paid to Owner after expenses, including payment of the base fee to the Manager, is the source of debt service payment. The incentive management fee is typically subordinated to payment of the Owner's Priority.

(e) The HMA grants limited and very specific rights to use the brand name, logos and marks, by and through the HMA.

(f) Termination of the HMA may occur if the Manager fails to meet certain hurdles as specified in the Performance Test. As discussed above, the Performance Test is designed to measure the performance of the hotel asset against its peer group (competitive set) AND the return of invested monies to the Owner. In the current market, terminations of the Manager for failure of the Performance Test are likely to be difficult, as the "peer performance" measure is coupled with the return of invested monies test, and therefore both prongs must be failed for termination to occur. Moreover, when "peer performance" is down marketwide, which is likely especially the case given most hospitality assets have been reduced to operating under skeleton crews or have been temporarily closed due to COVID-19, performance termination is even more difficult. The Performance Test is one of the most highly negotiated provisions of any HMA.

(g) The real estate, improvements, and facilities comprising the hotel and facility are owned by the Owner, not the Manager. The Manager may reserve the right to own and operate food and beverage venues or luxury amenities.

(iii) Finally, one needs to consider the following in the context of "owner-operated" property:

(a) Owner/operator or an independent operator generally holds title to the real estate and improvements, employs the employees, and has created or operates one or more locations under a signature name or branding structure, which brand is the property of the owner. Examples would be regional resort destinations or historic property locations.

(b) These properties generally enjoy greater flexibility in a workout or restructure situation because the lender needs to deal with only one party to access management and operations.

(c) An independent operator also has more flexibility in reframing or reinventing its asset, free of any constraints, performance limitations, or territorial restrictions that may follow from affiliation with a brand franchisor or a Manager. The downside is that the support infrastructure, major brand know-how and reservations, marketing, and economies of scale are also absent.

b. <u>Strategic Importance of Forms of Asset Operations</u>.

(i) Franchised property units are generally considered to be more efficient in circumstances of default and foreclosure. They present mezzanine or mortgage lenders with a greater number of options when dealing with a repositioning of the property. These factors primarily result from:

(a) FAs may have a liquidated damages provision permitting termination;

(b) The management company operating the property may be more efficiently terminated, and employees assumed and rehired, by merely changing the operator and preserving the FA;

(c) Financial matters are generally more transparent, as credit card and other revenues are usually isolated on a property-by-property basis and do not flow through a major brand receipt and disbursement system;

(d) Cost control is more direct as the FA does not typically cede control over systems expenses and centralized services to the same extent as a brand-managed property;

(e) The term of a FA is generally shorter with renewal terms (and fees) a negotiated part of the agreement; and

(f) Industry comfort letters or agreements between lenders and the brand franchise company provide for continuation of the contractual rights and benefits of the FA upon payment of the required fees following a foreclosure or deed in lieu of foreclosure.

(ii) HMAs are generally long-term agreements (thirty years or more) with specified provisions that make termination under any circumstance a difficult proposition:

(a) Many HMAs include specific authority for an owner and/or manager to close the hotel in the event of a force majeure.

(b) 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.

(c) 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 HMAs 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.

(d) 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 become ill at the hotel and are seeking recourse against owner and/or the manager.

(e) Termination provisions turn on economic performance measured against market performance;

(f) 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.

(g) 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.

(h) Employees, as employees of the Manager, create logistical and legal issues for substitution or replacement;

(i) SNDAs support brand continuity and distribution by maintaining and controlling site locations for the term of the HMA without regard to changing lenders or owners and a memorandum that runs with the land (or the agreement itself) is usually recorded; and

(j) Some SNDAs contain provisions for rights of first refusal or cure rights held by the Manager under mortgage documents that can be chilling to foreclosure sales.

(iii) There are, of course, no long-term HMAs or FAs in owner/independent operator-operated properties, but the following is noteworthy:

(a) If there is an independent management agreement, they are generally short-term (five years or less) and/or terminable at will or for a very small termination fee;

(b) Employees are employees of Owner or, if employed by the independent Manager, are generally easily transferable to Owner; and

(c) Independent management agreements are almost always subordinated to secured debt with no non-disturbance agreement and almost never contain rights of first refusal or other rights that can be chilling to foreclosure or other sales.

c. Cash Management and Control.

(i) Prior to the exercise or attempted exercise of any remedy in default, a complete understanding of the cash management process in place at the property, through the franchised and managed systems, must be determined.

(ii) The following analysis entails review of the senior mortgage loan and the mezzanine loan cash management structures in concert with any cash management or order of priority of payment set forth in the FA or HMA:

(a) with respect to “brand-franchised” properties:

(1) As a licensing agreement with a flat fee payment, all revenues stay in the possession of the franchisee with an obligation to pay over fees calculated in accordance with the FA; and

(2) Cash management may occur either through a self-managed or a managed system in concert with any loan document override provisions. This structure represents a straightforward method for a lender to create and maintain control over the cash proceeds of each operating location, as the proceeds and revenues can be directly deposited on a daily basis to an account with a local bank. Credit card receivables can be directed to be deposited in the same or a segregated account on a daily basis pursuant to a direction letter. The cash, once received, is held directly by the account, in the name of the borrower, for the benefit of the secured party, without any intervening chain of custody by any other party. The loan agreement then specifies reserve buckets on a periodic deposit basis, and an agreed budget payment on a periodic basis (usually monthly) for the operations of the property. Cash analysis is clean and generally crisp.

(b) with respect to “brand-managed” properties:

(1) Under HMAs, all cash and revenues are collected by, and processed through, the accounts created and maintained by the Manager. The cash is at all times the property of the Owner, but cash collection, retention, application and eventually payment to the Owner by the Manager, pursuant to the direction and authority of the HMA, occurs at all times by and through the Manager;

(2) Operating expenses (including all staffing costs) are, unless otherwise specified in the HMA, paid in an order of priority as determined in the sole discretion of the Manager. If cash is short, the Manager determines who is paid and who is not. The result may be that “lienable items,” and other expenses which a lender may wish to insist be paid earlier in the waterfall, are paid in the waterfall as the Manager deems appropriate;

(3) As all amounts received by the Manager in connection with the operation of a hospitality asset are and remain the property of the Owner or borrower of the property, and are not the property of the Manager, such amounts are subject to the contractual right of the Manager to first pay all operating expenses of the property (and the Manager's base fee) from this cash. However, as a matter of contract, national Managers are not generally disposed to the creation of any form of security interest in revenues at the hospitality asset, other than an agreement with respect to proceeds available after payment of all operating expenses and base fees (and, if payable, incentive management fees) are made to the Manager, either for reimbursement or direct payment of fees and expenses by the Manager. Therefore, typical cash management arrangements under loan documents are limited by the Manager to agreed reserve amounts, combining reserves required by the HMA for FF&E and other property costs, with the lender's request for reserve amounts under the loan agreement for items such as taxes, insurance, and debt service payments. Amounts placed in these reserve accounts for FF&E are fixed annual amounts on stabilized properties to a graduated annual scale (2, 3, 4 and sometimes 5% of gross revenues) for properties. The categories are typically: (i) FF&E, (ii) Real Estate Taxes, (iii) Property Casualty and Liability Insurance; and (iv) Debt Service Reserve (installment payments or principal reduction).

(4) The Owner may enter into cash management control agreements ("CCA") with both the senior mortgage lender and individual mezzanine lenders. These CCAs prescribe the amounts, timing, and distribution (if any) of cash balances after payment of expenses and debt service under each of the senior mortgage loan and senior and junior mezzanine loans. The result is that all cash is (or should be) captured, deposited and paid only in accordance with the provisions of the relevant CCA;

(5) Credit card receivables and payments may be made to a centralized account in the Manager's capital system and then allocated or netted out on a property-by-property basis (the Owner bears the credit risk of the Manager under this structure, which is prevalent in the industry);

(6) Cash payments made at the front desk and at food and beverage facilities generally are directly deposited into control accounts; and

In some instances, food and beverage payments (particularly if provided by a separate lessee or operator) made by credit card or cash are deposited into one of the hospitality asset's accounts (or the account of the Manager) and then remitted back between the parties on a weekly basis. Here, the party at risk is the party whose service payments are residing in the account of the "non-providing" party. However, both parties are at risk; ownership of the proceeds is a question of fact. A separate account for each service is advisable.

3. <u>Pre-Negotiation Letter</u>. A pre-negotiation letter is generally exchanged between borrower, lender, and guarantor for the purpose of setting ground rules, expectations, and reliance on certain exchanges made during the negotiations. Lenders will typically require that the parties execute a

pre-negotiation letter before discussing any specifics as to potential relief or other modifications under the loan documents due to the changes in circumstance wrought by COVID-19, so these letters arise both in the context of when an event of default has occurred and in the event an owner attempts to "get out in front" of an issue by providing notice of a potential or impending default.

a. Parties to Document.

(i) A Pre-Negotiation Letter is generally exchanged between borrower, lender, and guarantor for the purpose of setting ground rules, expectations, and reliance on certain exchanges made during the negotiations.

(ii) In the context of the borrower/guarantor and lender, focus provisions of the pre-negotiation agreement are: duration and scope of standstill or forbearance; events that trigger the termination of the standstill period; clearly defining negotiation goals or objectives; protection of exchanges, offers of settlement, admissions, or activities during the standstill period (if later litigation occurs); retention of rights and remedies under the loan documents; statement of either (1) no breach of recourse covenant or (2) clear allegation of breach of recourse carve-out provisions (or other provisions triggering liability) and limitations upon, or grants of right to, contact and converse with third parties.

(iii) Pre-negotiation letters also typically contain provisions that make clear that the negotiations between the parties will not act as a waiver of rights or remedies under the loan documents. In the initial draft of a pre-negotiation letter, the benefit of these provisions is typically limited to the party providing the draft, but the parties should consider whether or not such provisions should be reciprocal in light of the unique and urgent nature of the issues arising from the COVID-19 pandemic. Additionally, given the rapidly changing nature of governmental response to the crisis, special consideration should be given as to whether an express reservation of rights as to any statutes, laws, rules, regulations or other government directives or orders that are enacted to afford relief from the effects of the COVID-19 pandemic (and any claims derived from the same) is warranted.

4. "Deep Dive" Letter.

a. Consents. In connection with the pre-negotiation letter, lenders (particularly mezzanine lenders) who lack direct privity and recognition with third parties may request a deep dive agreement. The deep dive agreement grants elaborate permission and consent by the property borrower and mezzanine borrower to a lender or mezzanine lender for the purpose of holding discussions with any or all third parties without the borrower present, on matters which may be directly adverse to the interests of the borrower.

b. Direct Access. The deep dive consent agreement evolved as a means to allow the indirect or attenuated interests of lenders and holders of mezzanine instruments direct access to examine all aspects of the construction, development and operation of a project.

c. Notable Provisions. Notable provisions include: broad language regarding permission to participate in negotiations of issues and provisions; limited or no obligations to notify borrower of, or include borrower in, discussions; and the ability to interact directly with the Manager under the HMA.

d. Negotiation Rights. The deep dive agreement serves to legitimize lender contact and activities with third parties and fills the gap created, if any, by loan document provisions that may lack the breadth of granting authority to do so. It also picks up the negotiation rights of lender with Manager and others before the protection afforded by an SNDA or comfort letter may be effective.

5. Hybrid Asset Requirements.

    a. Review Real Estate Documents. Review real estate documents and determine the most likely result when there is a change in ownership as well as successor liability that might occur under any CC&Rs (e.g., how current and successor sponsor liability may be allocated).

    b. Contractual Requirements. Review contractual requirements or incentive agreements with retail, restaurant or amenities.

    c. Off-Site Facilities. Determine ownership and control of off-site facilities (i.e., golf, ski, concierge and spa).

    d. Licensing and Registration. Consider state licensing requirements and registration issues.

6. Forbearance Agreements. These agreements provide for lender to hold off from pursuing foreclosure or otherwise enforce some form of economic or legal benefit or credit enhancement, many times referred to as a "forbearance fee." The borrower usually seeks a sale, refinancing or capital investor for the distressed asset, while the lender is given the opportunity to seek corrections to the loan documents as well as a receipt of a forbearance fee.

G. INVESTOR CONSIDERATIONS.

1. File Review. The lead Investor should perform a detailed file review and examination with a focus on possible litigation from Investors.

    a. Privilege. Investors are not necessarily clients and are not subject to any privileged exchanges.

    b. Inspection. Investors are entitled to understand the project and to inspect financial and other reporting information.

    c. Lead Times. Examine lead times and cure right opportunities that may be open to Investors; inform them in writing of the timelines and consequences of failure to cure.

    d. Documentation. Carefully document actions taken and invite participation with lenders by all parties who may inquire or be entitled to participation.

2. Rights, Duties and Obligations. Examine rights, duties and obligations under brand-franchised or brand-managed documentation.

    a. Tying Provisions. Generally, brand and managed agreements have "tying" provisions to senior mortgage debt that may require notice and, in some cases, a cure right.

    b. Comfort Letters and SNDAs. Review comfort letters and SNDA requirements with brand parties.

    c. Timing. Review timing of performance, payment, and deliverables under pre-opening services and technical services agreement requirements to minimize expense and liability.

d. Franchise and HMA. Be wary of two levels of operation in most franchise situations: HMA of operator and FAs.

H. RECEIVERSHIP.

1. Purpose. Given the dominance of cash control and cash HMAs in commercial transactions, the appointment of a receiver would seem to be unnecessary. As more fully discussed in the bankruptcy materials, recent changes to the bankruptcy code even permit cash control agreements and security interest arrangements to survive the filing of a bankruptcy petition and remain in the form of the prepetition arrangements.

   a. More than Cash Management. Receivers have utility beyond cash management. A complicated asset will require significant lender review and interaction with a variety of parties, as well as contract vendors and purveyors. A receiver can conduct those interactions with the protection and approbation of the court in accordance with court authority.

   b. Consistent Property Management. The time frame between default and completion of a foreclosure or execution of a deed in lieu of foreclosure or foreclosure can range from a few weeks to a few years. With a receiver in place and certain contractual and operational activities being monitored neutrally, the lender may have more consistent property management.

   c. Customization. A receiver can be placed in possession of an entire property, or pursuant to a well-crafted order of the court, have narrow and specific oversight of certain activities. A receiver may be well-suited to monitoring and supervising cash flows in and out of the facility and monitoring on-site or other sales and commercial activities.

2. Protection.[6] Appointing a receiver provides protection to the lender with respect to its examination and inspection of the hybrid asset while providing protection against mortgagee-in-possession risk.

3. Considerations in Receivership.

   a. Applicable Remedy? Review the mortgage or deed of trust instrument for explicit granting language conforming to state laws (e.g., "The grantor/mortgagor hereby consents to the appointment of a receiver ex parte and without notice following the occurrence and during the continuance of an Event of default"). For example, in New York, a mortgage foreclosure plaintiff is not automatically entitled to the appointment of a receiver of rents and profits; this is an extraordinary remedy. *Meineke Discount Mufflers, Inc. v. Noto*, 603 F. Supp. 443 (E.D.N.Y. 1985). Generally, well-drafted mortgages and deeds of trust do not require a showing of the adequacy of the security.

   b. Order. Receivership requires motion or verified complaint (depending on laws of the state where the property is located) and entry of order of court (the "Order") of competent jurisdiction appointing the receiver. The Order can be a general appointment to assume supervision, control and operation of all aspects of the hotel asset, or it can be tailored to the specific scope of duties to be undertaken and directed by the receiver. The Order, then, can be limited to a specific task or group of tasks involving oversight of the cash and cash disbursements of the property and need not be a general delegation of the duties and responsibilities for the operation and management of the property. In this respect, the Order appointing a receiver and the tasks assigned to, and to be undertaken by, the receiver can effectively become

[6] For purposes of this example, and for this Chapter VII, Section D.3., the laws of the State of New York have been applied to the analysis; however, the laws of receivership vary from state to state.

narrowly and directly tailored to the source of the concern by the lender, such as inspection of cash management or other activities, without disturbing the larger functions of the Manager of the property.

c. Statutory Requirements. A receiver is typically required to fulfill specified statutory requirements in each state as prescribed by regulation or statute and may be subject to more stringent requirements pursuant to the Order.

d. Posting of Bond. A receiver is typically required to post a bond to secure performance in an amount that may be determined in accordance with statute or set by the court.

(i) Receiver fees (or commissions) can range from an agreed percentage, to a statutory amount, to an amount determined by the court order. The New York statutory amount is a maximum of 5% of the sums received and disbursed by the receiver, as allowed by the court that appointed him. N.Y. C.P.L.R. § 8004(a) (2009). With the exception of receivers appointed under Article 23-A of the General Business Laws on Fraudulent Practices in Respect to Stocks, Bonds and Other Securities, if there are no funds remaining at the termination of the receivership, the court may fix the compensation of the receiver and his attorney's fees in accordance with the services rendered and may direct the party that moved for the appointment of the receiver to pay such sums, as well as authorized expenditures incurred by the receiver. N.Y. C.P.L.R. § 8004(b) (2009).

(ii) A receiver is entitled to collect and receive a fee for services on its activities and is entitled to out-of-pocket and third-party expenses (typically, certain expenses are subject to court approval). "[A] receiver is entitled to be reimbursed for expenditures made by him which are necessary to preserve the receivership property and which are authorized by the order appointing him." *Hirsch v. PeekskillRanch, Inc.*, 100 App. Div. 2d 863 (N.Y. App. Div. 1984).

e. Fees. Significantly, in the hotel asset context, the receiver's fees are in addition to, and not in replacement of, contractual requirements of fee payment to the Manager and property manager in accordance with the terms of the HMAs.

f. Branded Properties. Complexity of appointing a receiver in the context of brand-managed, brand-franchised and owner-operated properties is significant.

(i) Historically, receivership functioned as a remedy, or delegation of responsibility, for the entire asset under operation. Given the structure of hybrid hospitality assets today, and the general contractual provisions of both brand-managed and brand-franchised agreements that create default and termination issues if a receiver of the property is appointed, the application of the remedy may be beneficial in instances where there is evidence supporting the appointment of a receiver with respect to cash management, operations, or in the case of an alleged breach by and among the property owner and either the Manager or the FA. In these latter instances, the receiver effectively becomes a court-appointed representative to sort through the issues among the various parties without subjecting a lender or the lender's representatives (such as loan servicers) to prospective liability for actions taken solely in connection with the servicing agreement.

(ii) Additionally, in some jurisdictions, hotel revenues may not be considered "rents" as a matter of state law and therefore not automatically subject to the control of the receiver unless a court order expressly empowering the receiver with that express authority is given.

4. Conclusion. In the context of hotel operations conducted by a Manager, receivership of the property is an unusual and imperfect remedy likely to increase the fee costs of operations. It is also likely to be vigorously opposed by the Manager and necessitate a successful showing to the court of significant evidence warranting the appointment. In the brand-franchised context, however, particularly where there may be multiple property locations in a single portfolio pool, with property operations conducted by single or local managers, a receiver may be useful to supervise operations, monitor cash and revenue operations, and provide asset analysis and supervision, under the shield of a court order. The fees paid to a receiver must be evaluated against the fees likely to remain due under the operators' management agreement for operations of the facility (unless the operators' management agreement is terminated as a result of the receivership) and the fees due under the brand FA. Generally, a receiver is not authorized to undertake duties or actions at the property or with the management of the asset which are not prescribed in the Order. Therefore the Order appointing the receiver must be crafted carefully to permit the receiver to effect and carry on the operational and administrative duties the lender is seeking to fulfill. An expansive Order appointing the receiver, encompassing all of the duties and responsibilities the lender desires the receiver to undertake in respect of the asset requires careful consideration and planning. Finally, in the evaluation of a complex hybrid asset, in which relationships with numerous third parties may need to be explored and evaluated, the independence and authority which can be granted to a receiver by court order may provide a shield to the lender as it assumes control and management of the asset. This protection may prove useful in projects where an accounting of residential purchase contracts with deposits may be necessary, offering and other sales documentation examined, and interested parties brought together in an orderly framework outside of a bankruptcy court.

I. DEED IN LIEU OF FORECLOSURE.

1. Background.

   a. Consensual Grant. A deed in lieu is a consensual grant and conveyance of the real and personal property comprising the hospitality asset to the senior mortgage lender in exchange for the agreement of the lender to forego collection of the indebtedness secured by the property.

      (i) In a market dominated by loan transactions for which liability for repayment of the debt is generally limited to the property in the base case, a deed in lieu of foreclosure has taken on the role of an efficient and balanced method to place the property in the hands of the mortgage lender.

      (ii) The mechanics of the transaction will be affected by the interests of multiple parties and the requirements set forth in the Intercreditor Agreement entered into by the senior mortgage lender and mezzanine lenders at the time of the initial closing.

      (iii) In addition, the property may be further subject to the legal operation and effect of an SNDA with the Manager or franchisor, licensing agreements with the Manager for the right to use the name in connection with the sale of residential condominium units and fractional or timeshare ownership products.

2. Strategic Considerations.

a. Other Stakeholders. A deed in lieu simplifies the relationships among the parties involved in the resolution of the asset. By accepting a deed in lieu, the lender must first deal with and remove from the equation an audience composed of mezzanine lenders and mortgage lenders, their participants, certificate holders, and other Investors. The sphere of liability is narrowed.

b. Property-Level Complications. The risk of property-level complications cannot be eliminated and will typically be transferred directly to the lender or its subsidiary or affiliate.

c. Minimize Interruptions of Business Operations. Conversely, because the deed in lieu requires the consent and cooperation of the Owner/grantor and Developer, the spectrum of issues affecting the asset can be processed in a manner which may minimize interruption of business operations and relationships with the Manager or brand franchisor.

3. Steps to Acceptance of a Deed in Lieu.

a. Traditional Structure of a Deed in Lieu:

(i) A grant deed in state specific form, generally a quitclaim or limited warranty instrument vesting title in a subsidiary or affiliate of the first mortgage lender.

(ii) The deed specifies that the mortgage or deed of trust remains unpaid and that the conveyance is subject to the legal operation and effect of the encumbrance securing the indebtedness. The indebtedness evidenced by any promissory note remains without discharge and the debt is still owed by the borrower.

(iii) The lender provides a covenant in favor of the borrower/owner not to sue for collection of the debt, provided certain negotiated conditions to the deed in lieu remain performed by the borrower. Historically, performance of these conditions and protection against breach was also secured by a guaranty from a creditworthy principal of the borrower. This method continues in use, but has been supplanted in some transactions by the additional structure of the admission of a “lender special member” in the surviving borrower (grantor) entity solely for the purpose of preventing a bankruptcy filing by the borrower entity (particularly if the independent directors in the SPE wish to be removed at the time of the granting of the deed in lieu).

(iv) In connection with the deed in lieu, an agreement and any documents supporting the transfer and sale of all personal property and tangible and intangible interests must be effected, including any substitute registrations or state and local licensing and regulatory requirements.

(v) Since there is generally a form of release provided to the grantor/Owner in connection with the deed in lieu, the lender must be certain to obtain comfort regarding the scope of sales deposits or timeshare and fractional interest contracts of sale that are outstanding, together with all other obligations surrounding the facility, such as restaurant and retail leases, incentive requirements, employment contracts, and other aspects that would be addressed in any third-party contract of sale for the asset outside of the deed in lieu context.

(vi) Costs of the transaction, particularly state and local recordation and transfer taxes, need to be considered when the consideration for the transaction is stated.

4. Conclusion. If a deed in lieu can be negotiated efficiently, with the reasonable collaboration and cooperation of all parties — senior mortgage lender, mezzanine lenders, brand franchisor or a

Manager — and the liabilities and future performance obligations balance out for the lender, acceptance of a deed in lieu can be productive and cost effective for a hybrid asset. By preserving the right to foreclose, a lender may significantly broaden the options to reframe and reposition the asset through a "friendly" foreclosure.

J. FORECLOSURE.

1. Introduction.

a. State Law Governed. Foreclosure of a mortgage or deed of trust is governed by state-specific requirements at each step in the process, from notice of default through advertisement, sale, reporting and conveyance of title. In New York, *see* N.Y. Real Prop. Acts §§ 1301 *et seq.* (2009). In California, *see* Cal. Civ. Proc. Code §§ 2924, 2931 *et seq.* (2009); Cal. Civ. Proc. Code §§ 725 *et seq.* (2009); *see also Royal Thrift & Loan Co. v. Cnty. Escrow, Inc.*, 123 Cal. App. 4th 24 (2004).

b. Clear Title. The traditional objective, to "clear the title and transfer it," holds renewed relevance for hybrid hospitality assets, which may include a hotel component coupled with a number of mixed-use products and operations.

c. Reconfiguration of Asset. A foreclosure action will permit the lender, under certain circumstances, to reconfigure the asset, through either the retention or termination of certain recorded and unrecorded property interests (such as condominium regimes), as well as to assume or terminate certain contract interests in the property or facility. *See, e.g., In re the Matter of the Application of Alexander & Reid Co.*, 259 N.Y. 648 (N.Y. 1932); *Medford II LLC v. Leely's Auto Supply, Inc.*, 9 Misc. 3d 1117(A) (N.Y. Dist. Ct. 2005); *Cf. In re Obligo,* 328 B.R. 619, 647 (E.D.N.Y. 2005). *See also In re 240 N. Brand Partners*, 200 B.R. 653, 660 (B.A.P. 9th Cir. Cal. 1996).

2. The Manner of Sale.

a. Highest and Best Price. A foreclosure sale brings to bear all of the lender's knowledge and due diligence work on the project: underwriting analysis, loan document negotiation and drafting, strategies for marketing and sale of residential condominium or fractional units, and selection and retention of the Manager or brand franchisor following the sale. The lender, through the trustee or other party conducting the sale, is charged with obtaining the highest and best price for the property. The manner of sale of the components comprising the hospitality asset is key in determining whether the lender has satisfied the requirement of obtaining the highest and best price (or justification and support for the lender "buying in" to the asset).

b. Hybrid Considerations. In a hybrid hospitality asset, considerations for the lender in structuring the manner of sale will include determinations relating to:

(i) Legal obligations relating to contract purchasers for each of the whole ownership units, timeshare and fractional units and/or hotel rental programs (if in effect), specifically:

(a) Did the contracts state that the agreement was subject to and subordinate to the legal operation and effect of the mortgage or deed of trust?

(b) Was the contract specific with respect to any duty of the Developer/borrower to complete the project or any unit?

(c) What termination rights did the Developer preserve?

(d) What are the limitations on damages in the event the project or any part of it is not completed? Are any portions of the project interdependent?

(e) Where are the purchaser deposits held in connection with executed contracts of sale, and has any portion of the deposits paid in connection with the contracts of sale been applied to construction of the project?

(f) Did the Manager or brand franchisor require an SNDA at the loan closing, and if so, what are the obligations of any successor in title with regard to the project? Are there any pre-opening services or technical services agreements in place which impose obligations on the successor owner or lender directly?

(ii) Legal obligations, if any, regarding the duty to create condominiums or subdivide the various component types of the project. Is there a legal obligation to record the CC&Rs creating each of the overall project condominium components, such as the residential condominium, commercial/retail condominium, or areas designated for all units intended to comprise whole ownership units or timeshare or fractional units? If such CC&Rs are "intended to be recorded" and are not yet recorded (x) at the time of the event of default or (y) at the time of the foreclosure sale, are they required to be recorded? CC&Rs are generally not recorded until just prior to the project completion and/or the commencement of unit closings and therefore the estate to be operated by the Manager or licensed by the brand franchisor may never exist.

(iii) Legal obligations relating to the payment or termination by foreclosure of mechanics' and materialmen's liens. Query whether a mechanic's lien primes a mortgage or deed of trust in certain states (and no statute prohibits its assignment), can acquisition of the lien position of the mechanic's lien by a third party or the senior lender (pursuant to advances made under the mortgage or deed of trust) allow the lien to be foreclosed and thus terminate the Manager or brand franchisor (as the mechanic's lien is not subject to the SNDA or comfort letter)?

(iv) Legal obligations, if any, relating to the leases for operation of third-party venues and legal obligations and disclosures relating to any approvals or licenses required in connection with the operation of a casino or the provision of alcoholic beverages.

c. Conveyance of Property. Once resolution of issues relating to the property, and those obligations which the lender has determined are required or are advisable to survive have been determined, the lender will confirm that such obligations and contractual requirements will be part of the sale, and the property sold and conveyed subject to and together with such obligations, or in the alternative, the lender will, pursuant to the superiority of the mortgage lien, convey the property free and clear thereof.

d. Multiple Parcels. The property may also be sold in one or more parcel offerings, if comprised of one or more subdivided or condominium parcels. Cal. Civ. Proc. Code § 2924g(b) (2009); *Ontario Land & Improvement Co. v. Bedford*, 90 Cal. 181 (Cal. 1891). *See also Colony Nyro Partners, LP v. Waterside Dev. Corp.*, 840 F. Supp. 15, 19 (S.D.N.Y. 1993).

e. Form of Sale. The form of sale and the advertisement of sale will mirror the decisions made with respect to the manner of sale in terms of obligations, duties, and liabilities to be terminated or assumed. The advertisement of sale becomes the basis for the form of contract between the successful bidder at the sale and the trustee or mortgagee making the sale.

3. Form of Advertisement.

   a. Manner of Sale. The advertisement will set forth the manner of sale, the property (real and personal) to be sold, and the property or liabilities to be assumed and to be excluded from sale. A minimum form of advertisement is prescribed by statute subject to judicial interpretation for legal form and sufficiency. See N.Y. Real Prop. Acts § 231 (2009); *Gordon v. Haltaufderhyde*, 54 Misc. 2d 841 (N.Y. Sup. 1967); *Cmty. Sav. & Loan Ass'n v. Abbate*, 91 Misc. 2d 18 (N.Y. Sup. 1977). The advertisement may also include: the amount of the deposit required for each offering and the result for failure to close in accordance with the terms of sale (or that the lender has no deposit requirement); the obligations with respect to contracts of sale to be included or excluded from the sale; the personal property (tangible and intangible) to be conveyed; the survival or termination of the HMA or brand FA and any liability assumed or excluded for purchaser deposits.

4. Results of Sale.

   a. Adequacy of Sale Process. The ability of the foreclosure sale process to prevail against any challenge by interested parties will be determined based upon (1) the manner of sale; (2) the form and frequency of advertising and other marketing efforts to cultivate interest in the sale and auction of the asset and (3) jurisdictional precedent defining the duties and obligations of the selling party in the conduct of the sale and the completion of post-sale formalities. *See, e.g., Continental Bank & Trust Co. of N.Y. v. W.A.R. Realty Corp.*, 60 N.Y.S.2d 595 (N.Y. Sup. 1946); *In re Brown*, 104 B.R. 609, 616 (S.D.N.Y. 1989). *See also Autry v. Patteson*, 14 Cal. 2d 723 (Cal. 1939); *Rasey v. Security First Nat'l Bank*, 124 Cal. App. 128 (Cal. App. 1932).

   b. Following Deed in Lieu. A foreclosure sale which follows acceptance of a deed in lieu proceeds without objection from the parties most likely to object to a change in the asset — the borrower and guarantor, as these parties have been removed from the equation through the deed in lieu process.

   c. Branded Issues. The interests of the Manager and brand franchisor in the foreclosure process (as with the deed in lieu process) are significant. Assuming that the hospitality asset is operating, the Manager and brand franchisor are invested in retaining the location. If the hospitality asset is under construction and has not yet opened, the Manager and brand franchisor (particularly in the event that either party has contributed significant money or other cash incentives to the development of the hotel) remain key players in the process with the likely right to standing to object to the form and process of the sale.

   d. Current Market Conditions. Current market conditions, however, are working to redefine the considerations that all interested parties may be willing to make (and concede) with respect to the continuity and operation of the hybrid hotel asset following a foreclosure. Outside of a bankruptcy, foreclosure presents the lender with the legal opportunity to reframe the components of the project by retaining or terminating certain property interests, by selling "subject to" or "free and clear" of contracts of sale, condominium regimes, leases, and other amenities. While termination of these interests may be negotiated, legal termination of the interests, absent agreement, may be an important option available through the foreclosure process.

5. Tax Treatment of Deed in Lieu.

   a. Nonrecourse Debt. The surrender (by deed in lieu or by foreclosure) of mortgaged property to the mortgagee, by an owner who is not liable on the mortgage debt, is treated as a taxable sale of the property. Gain or loss is recognized based on the difference between the face amount of the outstanding debt and the tax basis of the property. The property's fair market value is irrelevant in the computation.

b. Recourse Debt. The transfer of property in lieu of foreclosure of a recourse debt is also a taxable event. The difference between the property's basis and its fair market value is treated as gain or loss from the sale of the property. The difference between the fair market value of the property and the face amount of the liability is cancellation of indebtedness ("COD") income, taxable at ordinary income tax rates. The IRS Code provides for exceptions from current recognition of COD income in certain situations.

IX. TAKING OVER PROJECTS UNDER CONSTRUCTION: FINISH OR FINISHED?

A. INTRODUCTION. Where a distressed hospitality project has pending construction, lenders considering foreclosing upon the project, potential purchasers of foreclosed projects and prospective loan-to-own purchasers must undertake significant additional diligence, negotiation, risk analysis and transition planning prior to proceeding with the acquisition of a distressed hospitality project.

B. DILIGENCE. Prior to proceeding with a foreclosure, the lender should undertake a diligence review of the status of its pledged interests in the project permits and entitlements, architectural, engineering and construction agreements for the project, and bonds and insurance for the project and pre-ordered and stored materials. The lender should give consideration to which members of the design and construction team the lender desires to maintain or replace and should review and analyze underlying contracts, subordinations and assignments to confirm the lender's legal rights vis-à-vis the applicable project participants, in each instance also with a view toward any COVID-19 implications. If the construction project is significant, contractor and subcontractor payment and lien release status should be carefully reviewed. Project insurance and bonding should be reviewed by experts to determine whether such programs (particularly any existing subguard or wrap insurance programs) can be transitioned and maintained or will need to be replaced.

C. OBTAINING CRITICAL DILIGENCE INFORMATION. If the foreclosing lender determines that it is missing any desired or critical diligence information, such as underlying contracts, insurance policies or permit information, it may have rights to request such information under the terms of its loan documents, and borrowers may be more cooperative in providing such information prior to commencing formal foreclosure procedures. The need or desire to obtain critical agreements and information regarding the construction project might also become a significant factor in the decision whether or not to seek appointment of a receiver.

D. TRANSITION ISSUES. Construction project transition issues may vary depending upon whether the party acquiring the project through foreclosure desires to mothball the construction project or to complete construction. If the construction is to be suspended or terminated, the acquiring party should attempt to analyze and understand the severance, demolition, restoration, security and other project closure obligations and costs that the acquiring party will inherit, including those that might be imposed pursuant to the project entitlements and permits and local codes. If the acquiring party desires to proceed with construction, it will want to plan for retention or replacement of key members of the architectural, engineering and construction team. If the borrower is in material default in its obligations to the contractor, negotiations with the contractor and key subcontractors and suppliers can become more complicated and protracted. To the extent that retention of key members of the construction team is feasible and desired, the acquiring party should give primary focus to the negotiation of appropriate modifications or replacement of applicable contracts. Failure to do so can result in substantial project delays and increased costs to complete. Of note, Dunn & Bradstreet has declared that at least fifty-one thousand companies worldwide—one hundred sixty three of them being Fortune 1000 companies—have one or more direct suppliers in regions most seriously hit by COVID-19. With much of the damage caused by COVID-19 focused in Asia, there will likely be disruptions in supply chains for the construction of hospitality assets in the United States. Specifically, a thirty to forty-five day delay in delivery targets for supplies in the United States should be expected as significant quantities of construction materials come from China.

E. <u>CONSTRUCTION WARRANTY AND DEFECT RISK</u>. The party acquiring through foreclosure will want to preserve the existing construction warranties and indemnities to the extent possible, but this may not be feasible to the extent the underlying borrower is in material default under the project contracts or the contracts are not being assumed by the party acquiring through foreclosure. To the extent the general contractor and other key members of the design or construction team are to be retained, modifications or replacement to existing contracts and subcontracts may need to be negotiated, but by doing so, the Owner may be largely able to secure the benefits of the standard construction warranties and indemnities, and corresponding completed operations insurance coverages.

F. <u>INSURANCE</u>. Planning for transition or replacement of project insurance is critical regardless of whether the purchaser at foreclosure intends to suspend or complete the construction project. It may make sense for many institutional purchasers to incorporate the acquired project into existing portfolio-wide insurance programs, and sometimes these programs can be customized to be convertible into construction-based insurance for specific projects. If the purchaser is acquiring replacement insurance for a pending construction project, care should be taken to analyze problematic standard exclusions that could substantially undermine ongoing insurance coverage on a fractured construction project, such as prior work and professional errors and omissions exclusions.

1. <u>COVID-19 Specific Insurance Considerations</u>. 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. 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. The bottom line is to notify your insurance company of a claim without delay under any potential applicable insurance policy and have your coverage counsel review your specific policy. Specifically, you should review your coverage for the following:

    a. <u>Labor Coverage</u>. This coverage will address costs incurred to protect/preserve your business.

    b. <u>Contingent Business Interruption Coverage</u>. This coverage applies to situations in which your business suffers losses due to damage and interruption of your suppliers and vendors.

    c. <u>Builders Risk Policies</u>. Builders risk policies typically cover buildings under construction as well as materials, supplies and equipment, and business interruption-related costs related to the cause of loss. The key question is whether the COVID-19 related claim amounts to a physical loss. Every set of facts will be different and each policy will contain its own variations in language.

d. Pollution Liability Policies. These coverage insures against first-party and third-party claims arising from bodily injury, property damage, defense, cleanup, and related defense costs as a consequence of the release of a pollutant. These policies may cover the cost of decontamination of a project site if someone at the site has tested positive for COVID-19.

e. Commercial General Liability ("CGL") Policies. This coverage insures against claims made against your business. Most CGL policies issued after the SARS outbreak exclude losses incurred by viruses, bacteria or other micro-organisms that induce physical distress, illness or disease. Nonetheless, a review of the specific policy is worth your time.

f. Business Interruption Coverage. Coverage may be available for lost revenue resulting from the COVID-19 outbreak (e.g., due to canceled trips and conferences and loss of business due to compliance with public health directives requiring hotels and restaurants to close or reduce their operations). Although coverage for business interruption losses is typically included in property insurance policies, some insurance carriers have taken the position that virus contamination and related civil authority orders do not result in physical damage or physical loss to property, which they maintain is required for coverage for business interruption losses. Further, many property policies have specific exclusions as to losses due to the viruses or bacteria. These coverage issues will be the subject of intense litigation.

g. Civil Authority Coverage. This coverage may apply where a local government issues mandates or ordinances that prohibit guests and employees from reaching your property. This coverage is often provided as an extension of business interruption coverage, and is subject to many of the same coverage issues and defenses.

h. 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. This coverage is often provided as an extension of business interruption coverage, and is subject to many of the same coverage issues and defenses.

i. Extra Expense Coverage. This coverage will help your business continue running in the event that operations suffer a significant loss. As with civil authority and ingress/egress coverage, extra expense coverage is often provided as an extension of business interruption coverage, and is subject to many of the same coverage issues and defenses.

2. Acquisition Coverage. 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. Purchasers must consider whether an acquisition's existing insurance coverage covers potential losses it may experience as a result of COVID-19, 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.

G. DEFECT LIABILITY CONCERNS AND PROTECTIONS RELATED TO FOR-SALE RESIDENTIAL PORTIONS OF THE PROJECTS. If a project targeted for foreclosure involves pending construction projects that include for-sale residential properties, such as detached residences, condominiums or timeshares, the party acquiring through foreclosure will want to ensure it takes appropriate steps to protect itself from future construction defect liability vis-à-vis future purchasers.

1. Acquiring Property Through Single-Purpose Subsidiary. If allowed under applicable banking and finance regulations, acquiring the foreclosed property in a single-purpose subsidiary can provide significant liability protection to a bank or institutional investor.

2. Extent of Contracted Construction Services. Most financial institutions do not have the in-house expertise to complete a construction project, obtain necessary governmental approvals and market and sell residential units to the public. Most will need to contract or joint venture with one or more third-party builders and consultants if they desire to finish a for-sale residential project and market the individual units for sale. The arrangements with third-party builders can range from simply providing contractor or construction management services to providing full merchant builder services through sale, and even post-sale customer service and warranty services. The new owner may desire to form a new limited liability entity with a development partner or contractor. Such a joint venture might provide an attractive structure for allocating costs, responsibilities for completion of construction, marketing, property management and sale and future profits; but such ventures may be precluded under applicable banking regulations. Alternatively, contractual arrangements can be negotiated for an array of services including construction, construction management, property management, leasing, marketing, sales and warranty services. In negotiating these service contracts, the foreclosure owner should consider terms and incentives that will align the third-party participants with the new Owner's goals such as profit participations, service-level incentives and cost-overrun and completion guaranties.

3. Wrap Insurance and Completed Operations Coverage. If the construction project involves for-sale residential properties, careful negotiation of completed operations insurance coverage is critical. Many such projects are insured under construction wrap-ups (commonly referred to as owner controlled insurance programs ("OCIPs") or contractor controlled insurance programs ("CCIPs")) that jointly protect the project owner, the general contractor and enrolled subcontractors and suppliers for the project. Cost efficient replacement wrap-up programs frequently can be negotiated, but need to be proactively negotiated by construction insurance experts to address standard (and COVID-19 specific) exclusions and limitations that could impair the new Owner's coverages for a fractured construction project. To best protect the new Owner, the insurance programs should expressly cover preexisting work of the prior contractor and should be conformed to the construction contracts, state construction defect and right-to-repair laws, and applicable statutes of limitation or repose.

4. Warranties. The warranties received from replacement contractors and subcontractors can be a topic of substantial negotiation. As a starting position, the replacement contractor will typically argue that it should not be held responsible for the work in place performed by the prior contractor. While this is not an unreasonable position, a broadly worded exclusion carving out all prior work from the contractor's warranty could leave the Owner with very little warranty protection and impose a significant burden of proof hurdle if the Owner subsequently discovers a construction defect. If the replacement contractor is hired to pick up where the prior contractor stopped work, it will often be very difficult to determine after the fact whether one or the other contractor was the sole or contributing cause to a defect. If the replacement contractor's warranty broadly excludes prior work, the Owner may be left with no practical remedy against either contractor except for those

portions of the work that fall cleanly and discreetly into the category of new work performed solely by the new contractor. This might be the case for items like finishes and floor coverings, which typically are the last items completed, but the Owner may be left with uncovered construction defect exposure for such critical items as structural portions of the buildings, roof systems, and mechanical, electrical, HVAC and other building systems. Possible middle ground for compromise may be reached by negotiating the warranties on a trade-by-trade basis or requiring full warranties only for trades where the prior subcontractor is retained or a new subcontractor is willing to assume full responsibility for work in place. If the replacement contractor is performing broader services (e.g., full merchant builder services), is offered additional consideration, or is receiving significant incentives, the Owner may also have additional leverage to require the contractor to provide broader warranties and assume risks beyond its managerial control. In any event, the new owner will want to ensure it has (or has contracted for) the appropriate staffing to deal with the customer service and warranty claim processing with respect to condominium, timeshare and HOAs and other associations.

5. Dispute Resolution. The dispute resolution provisions in the construction services and residential sale documents should be drafted and negotiated on a coordinated basis to ensure that they are consistent with any applicable state right-to-repair statutes, insurance coverages (e.g., completed operations and contractual liability coverages) and the respective indemnity obligations of the design professionals, engineers, contractor and subcontractors. Alternative dispute resolution provisions, such as judicial reference or arbitration, are favored by many sellers of residential real estate, but should be discussed with counsel in light of the particular project and the applicable jurisdiction. Joinder of potentially liable parties into consolidated proceedings is often a critical issue in connection with defect claims brought by the project owner or owners or HOAs who subsequently purchase the residential units from the foreclosing project owner. In states where permitted, acquiring owners will also typically want to consider including waivers of the right to jury trials in all agreements for construction services and in all sales documents.

H. PURCHASERS OF LOAN-TO-OWN DEBT. Parties considering purchasing distressed loans for loan-to-own purposes should, to the extent possible, undertake the same analysis as provided above for a foreclosing lender with respect to hotel projects with partially completed construction. Ideally, the diligence and transition planning should be done prior to the purchase of the loan so that potential costs, delays and risks can be incorporated into the purchaser’s underwriting analysis for the loan acquisition. A party acquiring a distressed loan should also consider any potential borrower claims with respect to the construction lender’s funding and other obligations under the loan, as well as the terms and conditions related to any remaining lender funding obligations under the loan documents. If (i) the lender has refused to fund draws based upon borrower defaults or failure of funding conditions or (ii) the purchaser of the loan anticipates refusing future funding commitments based upon borrower defaults or failure of funding conditions, the purchaser should confirm the legal basis for withholding the construction draws prior to acquiring the loan.

X. NAVIGATING THROUGH BANKRUPTCY: BACK OF THE HOUSE BLUES

A. GENERALLY. The United States Bankruptcy Code (11 U.S.C. §§ 101, et seq., the "Code") has undergone significant revisions since the 1990s downturn. Any Owner contemplating a filing under Chapter 11 of the Code should make sure to file while he still has enough cash on hand to fund the Chapter 11, a process that has become complicated and expensive. Because of the complicated nature of a hotel bankruptcy case, hotel debtors often have to retain liquor license special counsel, employment law special counsel, chief restructuring officers, and, in the case of casinos, gaming law special counsel. Finally, debtors are required to pay United States Trustee fees until a final decree is entered, something that might not happen for a long time (particularly now, where court closures have been enforced due to COVID-19) after a plan of reorganization is confirmed or a bankruptcy case is dismissed.

B. MOTELS vs. HOTELS IN SINGLE-ASSET REAL ESTATE CASES. What does SARE mean? Congress amended the Code (pursuant to the Bankruptcy Reform Act of 1994 (the "1994 Act")) to include the following definition for "single asset real estate": "real property constituting a single property or project, other than residential real property with fewer than four residential units, which generates substantially all of the gross income of a debtor [who is not a family farmer] and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than $4,000,000." 11 U.S.C. § 101 (51B) (former). The $4 Million secured debt cap component of the SARE definition was deleted pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act") thereby significantly expanding the definition of SARE. So why is SARE status important? When a debtor files for protection under the Bankruptcy Code, others are "stayed" or prohibited from pursuing legal actions against such debtor. The automatic stay (a) can be lifted as soon as 90 days after the filing of a petition for relief under Chapter 11 by a SARE debtor and (b) subject to certain exceptions, cannot be lifted against a non-SARE debtor until the earliest of the time (a) the case is closed, (b) the case is dismissed, and (c) a discharge is granted or denied. 11 U.S.C. § 362(c). There is some inconsistency in case law with respect to determining which types of projects fall within SARE status. Hotels, ski resorts, golf courses and marinas generally do not fall within the SARE category. However, motels and other limited services hotels probably do qualify as SARE cases. The distinction lies in the fact that a hotel or resort involves an active, labor-intensive process geared toward providing customer services (restaurant, bar, etc.), whereas a motel has only limited amenities and relies more on the underlying real property.

C. CBAs AND THE CODE. The Code permits a debtor to make interim changes to or reject a CBA. If a debtor-owner wants to sell a hotel, it cannot do so if the applicable CBA has a provision prohibiting such until the CBA has either been modified to address such issue or been rejected in accordance with the terms of § 1113. Further, a third-party purchaser would be subject to the terms of the CBA to the extent that it provides for successor liability. Upon notice and a hearing, a court can authorize a debtor "to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by a CBA" if such changes are "essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate." A court shall approve an application for the rejection of a CBA if the court finds that:

1. Prior to the hearing, the debtor made a proposal that fulfills the requirements of § 1113(b)(1);

2. The authorized representative of the employees refused to accept such proposal without good cause; and

3. The balance of the equities clearly favors rejection of such agreement.

11 U.S.C. § 1113(c).

Also, while there is some variation among the various federal circuits, courts have generally found that the following nine requirements must be met in order to approve the rejection of a CBA and that the debtor bears the burden of persuasion with respect thereto:

1. The debtor in possession must make a proposal to the union to modify the CBA.

2. The proposal must be based on the most complete and reliable information available at the time of the proposal.

3. The proposed modifications must be necessary to permit the reorganization of the debtor.

4. The proposed modifications must ensure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.

5. The debtor must provide to the union such relevant information as is necessary to evaluate the proposal.

6. Between the time of making the proposal and the time of the hearing regarding approval of the rejection of the existing CBA, the debtor must meet at reasonable times with the union.

7. At the meetings, the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the CBA.

8. The union must have refused to accept the proposal without good cause.

9. The balance of the equities must clearly favor rejection of the CBA.

D. WAGE CLAIMS. In March of 2020, the Governor of California suspended the State WARN Act amid growing calls to close non-essential businesses and dramatically reduce workforce in an effort to curb the spread of COVID-19. Expect other states and jurisdictions to follow suit.

Nonetheless, should that portion of a claim under the WARN Act *(see Chapter VI: Working with Labor* for a discussion of the WARN Act) occurring post-petition be entitled to administrative expense priority? Prior to the 2005 Act, to the extent that no post-petition services were provided by employees, WARN Act claims constituted wages entitled to status as priority unsecured claim up to the cap set forth in § 507(a)(4) and any excess amount was treated as a general unsecured claim. However, pursuant to the 2005 Act and the holding in *In re First Magnus Fin. Corp.*, 403 B.R. 659 (D. Ariz. 2009), when no post-petition services are rendered, even if some of the sixty-day liability period under the WARN Act runs into the post-petition period, claims with respect thereto are not entitled to administrative expense priority. Certain wages earned prepetition and employee benefit plan contributions made prepetition are entitled to priority unsecured status under the Code. Wage, salary or commission claims, including vacation, severance and sick leave pay earned by an individual within one hundred eighty days before the filing of the petition date are entitled to fourth priority status. Contributions to employee benefit plans arising from services rendered within one hundred eighty days before the filing date are entitled to fifth priority status. 11 U.S.C. § 507(a). However, each individual employee's aggregate priority claim for wages and contributions is limited to $13,650, so the balance of any such claims would only be entitled to general unsecured claim status. 11 U.S.C. § 507(a).

E. EXECUTORY CONTRACTS, HMAs, PSAs AND LEASES.

1. What Is an Executory Contract? The term "executory contract" is not defined in the Code. The commonly accepted definition, originally expressed by Professor Vern Countryman, is: "A contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."

2. HMAs. Pursuant to § 365, subject to meeting certain conditions, a debtor has three options with respect to prepetition executory contracts and unexpired leases: (i) Assume, (ii) Assume and Assign, or (iii) Reject. A brief description of how these three alternatives work using an HMA as an example follows.

    a. Assume. An owner-debtor would want to assume an HMA if it has owner-debtor favorable terms in order to bind the Manager to the terms thereof. If the owner-debtor is in default under the HMA, at the time of assumption, it must (1) receive court approval upon notice and a hearing, (2) cure, or provide adequate assurance of the prompt cure of, any defaults, (3) compensate, or provide adequate assurance of prompt compensation for, any actual losses resulting from the default under the HMA, and (4) provide adequate assurance of future performance under the HMA. The requirements to cure and compensate do not apply to any default that is a breach of a provision relating to the insolvency or financial condition of the debtor, the commencement of the Chapter 11 case, the satisfaction of any penalty rate or the performance of any nonmonetary obligations (regardless of any provisions in the HMA to the contrary). 11 U.S.C. § 365.

    b. Assume and Assign. If the HMA has value to someone else, such as the purchaser of the hotel, the owner-debtor could assign the HMA even if the HMA contains provisions prohibiting such assignment. Also, any provision in the HMA conditioning an assignment or providing for modified terms upon an assignment would likely be unenforceable. In order to assign the HMA, the owner-debtor must (1) assume the HMA and, accordingly, meet the assumption requirements set forth above, and (2) provide the nondebtor party with adequate assurance of future performance by the assignee regardless of whether there has been a default under the HMA. What constitutes "adequate assurance"? It is up to the courts to decide and the analysis should be based on the specific set of facts and circumstances. Some courts may only require an assignee to show a greater ability to perform than the debtor and others may require an assignee to provide a deposit, financial statements or other forms of assurance. 11 U.S.C. § 365(f).

c. Reject. This is *the* option for HMAs entered into during the past few years since it provides owner-debtors with a way out of manager-friendly HMAs. Rejection (which requires court approval upon notice and a hearing) would constitute a breach of the HMA and excuse the debtor from any future performance of obligations thereunder. Even though the breach occurs post-petition, it is treated as a breach as of the date of the bankruptcy filing entitling the nondebtor party (i.e., the Manager) to a prepetition general unsecured claim for breach damages. 11 U.S.C. § 365(g). If the HMA contained provisions for any termination fees they would also likely be considered a prepetition claim.

d. Guarantees and Non-Disturbance Agreements. Although it may be difficult for a Manager to assert any meaningful claims against an owner-debtor, it may have a remedy against Investors in the owner-debtor. If any of the Investors or their affiliates executed a personal guaranty in support of the HMA, then, depending on the terms of the guaranty, the Manager may seek payment from such individual(s) in the event that the owner files a bankruptcy petition. Also, any agreement between the owner's lender and the Manager would be unaffected by the owner filing. Therefore, if such parties executed a subordination and non-disturbance agreement, the terms thereof generally would likely remain enforceable, including any agreement by the lender not to take certain actions with respect to the owner filing for bankruptcy protection or during the owner-debtor's bankruptcy case.

3. PSAs. PSAs generally constitute executory contracts and thus may be treated in the manner described above (i.e., assumption, assignment or rejection). However, if conveying title is the seller's only remaining obligation, case law is not entirely consistent in determining whether such constitutes an executory contract. Accordingly, whether a PSA constitutes an executory contract will hinge on the jurisdiction and the specific facts. In any event, a PSA is not executory if the purchaser already obtained an order for specific performance or similar judgment with respect thereto. Also worthy of note, where the deposit has been paid by a nondebtor purchaser under a PSA, but delivery and final payment is still pending, regardless of any language to the contrary contained in such PSA, the commencement of the Chapter 11 case does not constitute cause for the purchaser to terminate such PSA.

4. Intellectual Property Licenses. Nonexclusive IP licenses are a special type of executory contract subject to specific assumption, assignment, or rejection provisions. A hotel owner-debtor licensee has the option of assuming, assigning, or rejecting a nonexclusive IP license. In order to protect the business of a non-debtor licensee, provisions under § 365(n) protect a non-debtor licensee in the event that a debtor licensor rejects an IP license. In such case, the non-debtor licensee can choose to (a) treat the rejection as a breach of the contract or (b) retain its prepetition rights to the IP, including rights under any supplemental agreements. Note, the definition of IP does not include trademarks and trade names.

F. REVENUES AND COLLATERAL.

1. Hotel Room Revenues Constitute Cash Collateral and Are Subject to Restricted Use. The definition of "cash collateral" was amended pursuant to the 1994 Act to include "fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties." A debtor may not use, sell or lease cash collateral unless and until either (a) the creditor with an interest therein consents thereto or (b) after notice and a hearing, the court authorizes such use, sale or lease (unlike property of the estate (i.e., property that does not constitute cash collateral) which may be used, sold or leased in the ordinary course of business without a court order during a Chapter 11 case unless a court orders otherwise). 11 U.S.C. § 363(c)(2). Therefore, a hotel owner-debtor must now receive either (a) consent from any party(ies) with an interest in the hotel or (b) court authorization prior to using hotel room revenues. As part of its first day pleadings, a debtor typically files a motion for entry of an interim order to use cash

collateral. If granted, the debtor can then use cash collateral until there is sufficient time to provide parties in interest at least fifteen days prior notice of a final hearing. Federal Rules of Bankruptcy Procedure, Rule 4001(b). At both the interim and final hearing, in order for a debtor to be granted the use of cash collateral, the debtor must "adequately protect" those parties with a security interest in the hotel. Adequate protection typically takes the form of (a) the showing of evidence that the parties are oversecured; (b) payment of interest and fees; (c) providing first priority replacement liens on unencumbered property; and/or (d) providing junior liens on property that is encumbered.

2. <u>Perfecting Interests in Hotel Room Revenues</u>. How a lender should perfect an interest in hotel room revenues depends on whether such revenues constitute rent or accounts receivable. Unfortunately, this issue is not addressed by either the 1994 Act or the 2005 Act. If hotel revenues constitute rent, then the interest in such revenues should be perfected under local real estate law. If hotel revenues constitute accounts receivable, then the interest should be perfected by filing in accordance with the Uniform Commercial Code. Lenders should consider perfecting under both systems and preparing their loan documents to expressly create a security interest in hotel revenues. On a related note, the Code was revised pursuant to the 1994 Act to clarify that post-petition rent and hotel revenues are subject to a prepetition security interest regardless of whether the security interest was perfected under applicable state law procedures. § 552(b).

XI. BUYING FREE AND CLEAR UNDER 363: WHEN A STANDARD PURCHASE AND SALE TRANSACTION IS SUBSTANDARD

A. 363 SALES. Section 363 of the Bankruptcy Code provides for the sale of financially distressed businesses or, in our case, hotels or resorts. A 363 sale is usually handled much like a controlled auction. A 363 sale typically includes an initial bidder or "stalking horse," who reaches agreement to purchase assets from a Chapter 11 debtor. The purchaser and debtor-in-possession negotiate an agreement which contains certain protections for the stalking horse in the event the hotel is ultimately transferred to a higher bidder. These protections include breakup fees, expense reimbursements up to a cap, access to information and consent to the terms of the auction (such as bid increments). The bidding procedures and rules for the sales process require the approval of the Bankruptcy Court.

1. Advantages of a 363 Sale.

   a. Free and Clear of Monetary Liens and Claims. Historically, the purchaser has been able to acquire the hotel assets free and clear of all monetary liens and encumbrances.[7]

   b. Liability. A hotel acquisition is similar to buying an ongoing business. A 363 sale reduces the risk that purchasers will inherit some or all of the business' liabilities.

   c. Acceptance/Rejection of Executory Contracts. Favorable contracts and leases can more easily be included in a 363 Sale.

[7] An exception to this widely established rule was created by the *Clear Channel* decision. In *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, the Ninth Circuit Bankruptcy Appellate Panel reversed the bankruptcy court's order and held that a senior secured creditor's credit bid, in an amount less than the aggregate value of all liens against the property in question, did not satisfy relevant sections of the Code necessary to permit the sale to be "free and clear" of the existing junior liens of the property. Consequently, purchasers cannot necessarily rely on a court order stating that assets are taken clear of all monetary liens and encumbrances. The ruling's impact will be strongest when the amount of the claims secured by the property to be sold exceeds the value of the property and one or more of the lienors does not consent to a sale "free and clear."

d. Fraudulent Transfer. Avoidance of exposure to claims of fraudulent transfer laws.

2. Disadvantages of a 363 Sale.

   a. Competing Bids. Competing bids are permitted which can drive up the purchase price. Purchasers cannot rely on the enforceability of "no-shop" provisions and an auction is usually required.

   b. Opposition. A 363 sale requires requisite approval of debtor's creditors and thus impaired creditors may oppose sale at the bankruptcy hearing. Therefore, the purchaser's bid may not succeed for reasons unrelated to the merits of the bid.

   c. Timing. A sale outside the bankruptcy proceeding may occur more quickly and be less costly than a 363 sale in bankruptcy.

   d. Lack of Exemption from Stamp and Other Taxes. In June 2008, the United States Supreme Court definitively ruled that certain tax exemptions previously applied to 363 sales are not valid. In order for the sale to gain tax exempt status, it must be approved under a confirmed plan or reorganization.

3. Characteristics of a 363 Asset Purchase Agreement. A 363 purchase agreement is typically similar to an agreement made outside of the bankruptcy context with some exceptions:

   a. Bidding Procedures. A 363 purchase agreement typically contains detailed provisions describing the process, including the bidding procedures.

   b. Cure Costs. A 363 purchase agreement includes a process for the designation, assumption and assignment of contracts and includes mechanisms for the determination and payment of cure costs related to contract assumption.

   c. Representations and Warranties. A 363 purchase agreement typically has substantially fewer representations and warranties than in a standard purchase agreement, and generally will include survival for a limited duration post-closing, if at all.

   d. Conditions. A 363 purchase agreement has few conditions; in most cases, a court order is all that is needed.

   e. Post-Closing Covenants. A 363 purchase agreement typically contains few seller post-closing covenants, depending on the seller's ability to perform any covenants post-closing.

   f. Governing Law. In addition to state law, the parties will submit to the Bankruptcy Court's jurisdiction for the resolution of disputes.

   g. Enforceability. The executed agreement is not binding on the seller until court approval is obtained.

4. Bidding Process Considerations.

   a. Stalking Horse. The stalking horse bid is used as a floor for other offers.

   b. Breakup Fees.

(i) Compensate stalking horse for costs.

(ii) Considered "outside the ordinary course" of seller's business and thus must be approved by the court.

(iii) Courts typically approve 3% of the purchase price (including assumed liabilities), and balk at excessive fees that have a chilling effect on the bidding process.

c. Reimbursements. Stalking horse bidders may request reimbursement of out-of-pocket fees.

d. Qualification. Bidders must be qualified and demonstrate the ability to pay the purchase price.

e. Hard Deposits. Qualified bids typically include a cash deposit, terms similar to that of stalking horse bid and an irrevocable purchase agreement.

f. Backup Bidders. Backup bidder provisions can provide that the runner-up bidder will be bound to close its deal if the agreement with the first bidder fails.

XII. ANALYZING MIXED-USE HOTELS & RESORTS: NOT OVERDEVELOPED, BUT UNDERDEMOLISHED

A. RESIDENCES. 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.

B. GENERAL ISSUES. There are numerous issues that can arise in a troubled hospitality project, especially in a mixed-use hotel project containing one or more types of residential components. The discussion below is intended to identify several of these issues and is written from the perspective of a purchaser/Owner stepping into a partially completed troubled hospitality project, having had no prior experience with the project. This perspective provides a platform to discuss and review all aspects of the project. In fact, Developers of troubled hospitality projects often change course in mid-development (including changing law firms and/or other consultants) and, similarly, when a lender forecloses on a troubled hospitality project, the lender will step into the middle of the development and will need to perform a comprehensive analysis of every aspect of the project. The most common residential components are discussed below.

1. Condo-Hotel (privately owned condominiums primarily operated as rental inventory for hotel operations). The purchaser should, among other things, determine the condominium structure of the condo-hotel and identify exactly what the purchaser is buying. If the project is 100% condo-hotel (no traditional hotel component), the purchaser must determine whether the condominium includes a commercial hotel unit that has rights to the income stream of the condo-hotel units or, whether there is no such hotel unit, in which case the purchaser may likely have no remaining ownership interest in the project once all of the condo-hotel units are sold. If the project includes a condo-hotel component and a traditional hotel component, it is important for the purchaser to understand the control and cost allocation provisions of the governing documents to ensure that the hotel is not unfairly subsidizing the cost of the condo-hotel operations. In both a 100% condo-hotel project and one combined with a traditional hotel, the purchaser must make sure that it will

have sufficient control over the maintenance of the room interiors, the provisions of hotel services and the ability to be compensated for hotel-related costs with respect to owners not participating in the hotel rental program.

2. Branded Residential (privately owned condominiums primarily intended for residential or owner vacation use). The purchaser of a troubled mixed-use project that includes branded residences also must determine the control and cost allocation provisions in the governing documents. Depending on how the project was originally structured, the purchaser may find that the condominium association has so much power as to disrupt the Owner's ability to operate, maintain and renovate the hotel or that the condominium association is not paying its fair share of the costs to maintain the areas of the hotel in which it and its members derive benefits or have use rights. Working out a troubled hospitality asset in this environment and returning it to financial viability will be extremely difficult.

3. Timeshare/Fractional. The issues for a purchaser of a troubled mixed-use hotel/timeshare project are largely the same as discussed above for a mixed-used hotel condominium project (i.e., control and cost allocation are most important). There are a number of important issues specific to a timeshare that the purchaser should review and understand. For example, the purchaser should review how the timeshare rental program interacts with the hotel reservation system, including the use rights of the Unit Owners over the hotel facilities.

4. Other Mixed-Use. Other mixed-use projects may include horizontal and vertical subdivisions with hotel, residence, office, retail, recreation, entertainment and/or other components. The most important issues facing a buyer of a hotel in such a project are control (if any) over the project and cost allocations of the hotel. Often in a larger mixed-use project the hotel will be one of many components and will not have control over the project or any master association. In this case, it is important to see what types of rights and protections the hotel has, such as veto and approval over association rights, self-help rights and other remedies and ability to make alterations to the hotel.

C. DUE DILIGENCE.

1. Evaluation of the Project. Evaluating a troubled hospitality project requires a financial and feasibility analysis as well as a legal analysis. In a nutshell, the financial/feasibility analysis evaluates how the project should be positioned and what changes need to be made to position it ideally, and the legal analysis evaluates whether such changes can be made and how such changes should be made.

    a. Registration Documents. Review all registration documents and public reports to make sure they are all current and to identify each state in which the project is permitted to market and sell units. Also, reviewing a public report will provide a clear overview of the project and, thus, should be done at the beginning of the review process.

    b. Land Sales and Securities Laws. Review state or federal land sales violations and/or securities law violations. This is especially important with respect to condo-hotel sales as there are numerous ways that a condo-hotel project and its sales program, if not structured properly, could violate securities laws. In extreme cases, violations could allow purchasers under contract and those who have closed on their units, to rescind their contracts and receive their deposits and purchase price proceeds back. The purchaser should be indemnified by the Owner (or ideally a parent or other financially viable entity) for any such violations that have occurred prior to the sale date. In any event, a litigious environment and the possibility of rescission and return of deposits will again make working out a distressed condo-hotel extremely difficult.

c. Existing Purchase and Sale Documentation. Review all PSAs applicable to purchasers who have not closed. The purchaser of a troubled hospitality project will be sensitive to the ability of a purchaser under contract to rescind his/her contract and/or may want to change the direction of the project and terminate some or all of the contracts. Thus, the PSAs should be reviewed for issues such as:

(i) Rescission rights;

(ii) Use and return of deposits;

(iii) Representations and covenants of Developer; and

(iv) Owner's termination rights.

d. Owners' Associations. Review all cost allocation and assessment provisions. The cost allocations are particularly important to the purchaser of a mixed-use project; especially one that is financially troubled. The purchaser should hire experts, if necessary, so that the allocations and costs associated with the hotel component of the project can be clearly understood. Also, the purchaser should coordinate with the HOA to determine the amount of unpaid assessments and the collection procedures to ensure that assessments necessary for the maintenance of the project have been diligently collected and placed in reserves. The purchaser should carefully audit the HOA budgets for accuracy and sufficiency. The purchaser should also review the amount of assessments attributable to the Developer and whether or not any developer assessment subsidies apply.

e. Project Governing Documents. The purchaser should review the project governing documents to determine the Owner's ability to control project facilities and common areas. If there are significant common areas owned by the HOA or the Unit Owners, the purchaser may not have sufficient control to operate, maintain and/or refurbish the hotel in the manner the purchaser would prefer. Lack of proper control will significantly impact the speed and success of any hospitality project turnaround. These documents include the CC&Rs, REAs, Master Declarations, HOA Bylaws, Easement Agreements and HOA Articles of Incorporation.

f. Condominium Association Documentation. The purchaser should review the condominium association documentation, such as the bylaws, to determine the voting and control provisions and the extent to which the purchaser would have any control over the HOA.

g. Rental Program. Particularly for a condo-hotel project, the purchaser should analyze the rental program as set forth in the rental program agreements and the condominium governing documents. Some issues of particular importance are:

(i) What rental information and materials have been provided to purchasers under contract and Unit Owners prior to taking title to their Units?

(ii) Do rental agreements need to be revised? If so, what are the legal ramifications?

(iii) What percentage of the rental revenues is retained by the Owner and what portion is paid to the Unit Owner and what expenses are funded from each party's portion?

(iv) Are hotel expenses entirely reimbursed out of the nightly fees paid by Unit Owners or are expenses split with the Owner?

(v) What percentage of condominium units participate in the rental program?

(vi) Are nonparticipating owners required to contribute to the cost of hotel services?

(vii) What are the Unit Owner's use rights and Owner's reservation procedures?

(viii) Are FF&E reserves adequately funded? What are the nonparticipating owner maintenance and FF&E requirements, and how do nonparticipating units comply with brand standards?

2. Legal Analysis.

a. Management (Hotel, Project, HOA).

(i) The HMA should be reviewed to determine whether it can be terminated and, if so, at what cost. We have seen a number of troubled hospitality projects where the Manager has been changed after signing the HMA but before the project opening. This is particularly applicable to a foreclosing lender who may need to terminate an existing HMA in order to sell the project. It is also possible that the Manager may be willing to renegotiate the agreement rather than having it terminated.

(ii) Another important issue to consider is whether a foreclosing lender must assume the HMA and, if not, whether any fees or liquidated damages apply. HMA issues are also discussed in more detail below.

b. License Agreements. The issues applicable to the license agreement and any other Manager-related agreements (e.g., pre-opening and technical services agreement) are nearly the same as for the HMA and should be analyzed together with the HMA.

c. Sales and Marketing. There may be more than one sales and marketing agreement, especially if there are multiple product types being marketed in the project (e.g., there may be a different sales team for condominiums than for the fractional interests). The sales and marketing agreements should be evaluated to determine whether they can be terminated and whether they contemplate a change to the product being sold thereunder or whether any of the products being sold under the agreement can be reduced or discontinued. The compensation provisions should be evaluated to see whether they are still feasible. It is likely that the sales and marketing agreement can be renegotiated given the troubled nature of the project and/or the potential repositioning of the project and product mix.

d. Purchase Agreements. Possibly the most important agreement to be reviewed is the form of condominium purchase agreement, particularly if a number of agreements have already been entered into with purchasers (and throughout this discussion we have assumed that multiple purchase agreements have been entered into, which is usually the case).

(i) The form of the purchase agreement can severely restrict the ability of a Developer or foreclosing lender to make changes to the project structure or, for that matter, any other aspect of the project due to the risk that changes will lead to purchaser rescission rights. Changes to the project may violate certain covenants or representations made in the purchase agreement and provide the purchasers with a rescission right. In a down market, with purchasers looking for any reason to get out of their purchase agreements, you don't want to give purchasers a right of rescission but, on the other hand, if a change needs to be made to the project for its long-term health or to ensure its success, then the Developer or foreclosing lender may have to gamble and open the door to possible rescission rights.

(ii) Both the Developer and foreclosing lender must assess the risk of their actions or inactions to the project increasing the purchasers' ability to invoke rescission rights. Rescission rights can derive from a number of sources. Changes to the project documents, to the units or the overall project and its services and amenities can often lead to rescission rights. Usually these changes are measured by a material adverse change standard in the purchase agreement or under applicable law. If the changes rise to such a level, then the purchaser may have the right to rescind the purchase agreement.

(iii) The purchase agreement will usually contain many representations on various aspects of the project and provisions in the project documents, each of which must be analyzed in light of proposed project changes or Owner/Developer financial issues. Disclosures and representations made in the purchase agreement that later cannot be satisfied may lead to rescission rights as well. For example, the purchase agreement may indicate that the project will be complete by a certain date. These dates are often optimistically stated and, thus, a troubled hotel project is likely to be behind schedule, and especially so where the effects of COVID-19 are affecting the ability of employees to attend the workplace. Sometimes, due to state or federal requirements, an outside closing date must be stated in the purchase agreement. These dates will likely be in jeopardy with respect to a troubled hotel project. Also, the purchase agreement may contain representations about certain facilities or amenities or certain assessment or cost amounts that might change due to the troubled nature of the project.

(iv) In a litigious climate, especially with property values plummeting, some purchasers will do anything to get out of their purchase agreements. If the purchase agreement has some sort of loophole or defect, a purchaser will try to exploit that as an excuse to rescind. Thus, the purchase agreement must be carefully reviewed for compliance with applicable law, particularly the applicable state and federal registrations and real estate sales laws.

(v) Other provisions to review in the purchase agreements include Owner's liquidated damages for the purchaser's default, dispute resolution procedures, the Owner's ability to terminate the agreement (e.g., pre-sale conditions), deposit requirements (e.g., whether they are held in escrow).

e. <u>Rental Agreements</u>. Rental agreements are extremely important for projects that have a condo-hotel component. However, even for non-condo-hotel condominium projects and fractional and timeshare projects, any rental agreements that have been entered into with prospective purchasers must be evaluated. Typically, however, foreclosing lenders do not have to assume existing rental agreements. With respect to condo-hotels, the rental program agreement must be reviewed together with the entire rental program and the hotel services and operations (as discussed below in more detail). This analysis will involve a review of the rental agreements and the project documents. This an especially critical analysis because of the significant impact the rental program has over a condo-hotel project, particularly in the areas of cost, control and quality standards.

f. <u>Leases/Operating Agreements</u>. Any executed leases, operating agreements and similar agreements should be reviewed. A foreclosing lender might not have to assume some or all of these types of agreements, in part depending on whether and when they were executed and/or recorded and whether they are subject to a non-disturbance agreement.

3. <u>Financial/Feasibility Analysis</u>. The financial/feasibility analysis often involves engaging outside consultants and experts who might review all aspects of the project as well as the market segment

in which the hotel is positioned, the current market outlook and the long-range market outlook. Some issues that a financial/feasibility analysis might address are set forth below. Each of the financial/feasibility issues and decisions highlighted below could have legal implications, which are discussed in more detail in sections below.

a. Financial Status of the Project and the Developer.

(i) Will the Developer be able to complete the project as planned?

(ii) Will the project require additional equity capital or loans and will the Developer be able to cover cost overruns?

(iii) Has the Developer taken out loans under Title I or Title IV of the CARES Act? What is the status and impact of these on the project?

(iv) What is the cost to complete the project as planned? Can or should the project be modified to reduce the cost to complete?

(v) Is it likely that residential purchasers under contract will actually close? If not, what are the financial implications of any such failure?

b. Construction Status and Cost to Complete.

(i) What is the status of the construction?

(ii) Is the construction on schedule and on budget?

(iii) If not on schedule or on budget, what is the reason and can it be corrected?

(iv) Is the quality of the construction adequate? Do changes have to be made?

c. Project Design/Theme.

(i) Does the project design make sense in the current and foreseeable future? Should it be repositioned?

(ii) Should the project be scaled back or portions temporarily halted or terminated?

d. Product Mix.

(i) Does the current product mix make sense in this economy?

(ii) If it is not likely that purchasers under contract to buy residential units will close, should the residential units be converted to hotel inventory or another type of residential product (e.g., from condominium to timeshare)?

e. Sales Team.

(i) Are they effective?

(ii) Should they be replaced, especially given any change in product mix or repositioning of the project?

f. Manager/Brand.

(i) Are they effective?

(ii) Should they be replaced, especially given any change in product mix or repositioning of the project?

g. Timeline.

(i) What is the critical timeline to finish the project?

(ii) Is it on schedule?

(iii) How will changes to the project affect the timeline?

4. Project Structure. The project structure is the organizational structure set forth in the governing documents for the project, including governance provisions, cost allocation provisions, use restrictions, use rights and control provisions. Evaluating the project structure is a complex process that involves analyzing not only the project governing documents, but also the budgets, maps and other related items, as further discussed below.

a. Project Documents. The areas of particular importance with regard to the project documents are cost allocations, project maintenance and standards, control over the various aspects of the project, and the rental program.

b. Cost Allocations/Budget. The cost allocation scheme is especially important in mixed-use projects containing a hotel or condo-hotel where the Developer will maintain an ownership interest in the project after the residential units have been sold, which is typically the case, or where there are other non-hotel components, such as office, retail or commercial components.

(i) What are the cost allocations? The cost allocations are simply the allocation of common area project costs among the various components of the project (e.g., among hotel, retail, residential, commercial, retail, casino, nightclub, theater, or any other specific component that might be present in a particular project).

(ii) Why is cost allocation important? If the costs are not adequately allocated among the various components of the project such that the hotel is allocated a disproportionate share of the costs, the hotel could be saddled with subsidizing the other components of the project. Miscalculated cost allocations almost always are miscalculated in favor of the other components (especially residential components) and not the Developer. Sometimes this is intentional (e.g., for sales purposes with respect to residential units), but nevertheless, the extent to which the hotel is subsidizing the other components needs to be clearly identified. The cost allocation and budget analysis may not appear to be a legal issue, but from experience, we can say that it permeates all of the project documents and legal aspects of the project and we, as lawyers, typically find ourselves closely involved with the cost allocation and budgeting process.

(iii) How are costs allocated? To create a cost allocation scheme, the areas of the project should first be divided into use areas. The costs applicable to each use area should be calculated by preparing pro forma budgets for each such use area. Then, with respect to any use areas which are shared by more than one project component, the costs applicable to that use area should be allocated among such project components. These allocations might be performed by any number of methods, including by square footage, by unit count (if allocating between residential components), by actual usage, equally or by some other rational methodology. Often, various budget line items within the same budget are allocated by different allocation methodologies. For example, the cost to provide security may be allocated among the components by square footage, while management costs may be allocated equally among the components.

(iv) What if cost allocations have already been made? If the budgets and cost allocations have already been established, the first analysis is to determine whether they are adequate. In the case of a foreclosing lender or purchaser, the successor owner might not have access to the person who prepared the original budgets and must therefore recreate the entire process. A successor Owner must determine whether any adjustments need to be made to address any issues specific to the troubled nature of the asset. Some costs may need to be shifted or eliminated (for example, by eliminating certain amenities or facilities) or revised to address changes to the project (for example, due to changes in the product mix or the size of the project).

c. Use Areas/Project Maps.

(i) The use area project map is a map depicting each of the use areas within the project. A use area/project map will delineate different use areas within the project and the relationship to other areas including shared or prohibited use and access rights. For example, an "exclusive common area" might be an area which is either owned in common or owned by the Owner, from which all Unit Owners derive a benefit but to which access is restricted and is, thus, exclusive to the Owner (e.g., back of the house, mechanical areas, elevator shafts), whereas a "nonexclusive common area" might be an area that is either owned in common (by owners of different use areas, if those use areas have been subdivided and sold to third parties) or by the Owner, from which all owners derive a benefit and to which all owners have nonexclusive access (e.g., hallways, walkways, escalators, pool areas, etc.).

(ii) For any mixed-use project, a use area project map is extremely beneficial. The use area project map not only provides a visual aid to help comprehend all the areas and uses of a project, but also delineates use area square footage, which is essential in determining cost allocations.

d. Control. Another critical area concerns the control mechanisms in the project documents. In a mixed-use project containing a hotel, the project documents should provide the Owner with the maximum possible amount of control over the project.

(i) The Owner will, like it or not, be responsible for ensuring that the entire project adheres to the brand standards, even those portions that are not owned by the Owner (e.g., the residential portions that are owned by third parties). The Owner must be certain that it has the ability and flexibility to operate the hotel in any manner that it wishes (including to open, close or remodel any portion of it). The Owner must be able to ensure that Unit Owners cannot disrupt the hotel operations or marketability of the hotel. This can be difficult given the integrated nature of a mixed-use residential and hotel project. The Owner must be able to ensure that the budget and costs applicable to the project are under control and that the project is maintained to acceptable standards. For these and many other similar reasons, the Owner must have as much control as possible over the operations, property and maintenance of the project.

(ii) Because it is not often feasible for the Owner to own the entire mixed-use project, the Owner's control over the project is usually accomplished through a very strict reciprocal easement agreement or similar type of agreement where the Owner has significant enforcement authority and control over the project. Another way to obtain maximum control is to limit that portion of the overall project that is owned by Unit Owners and their HOA. If possible, the residential units and their ownership should be defined as and limited to air-space units within the hotel project with all open area surrounding them within the project (e.g., building infrastructure, hallways, back of the house, lobby, elevators, roof, balconies) owned by the Owner. Of course, if the project is not already structured in this manner, due to material change/rescission issues, the Owner will face limitations on how much the project structure can be revised.

(iii) Other control-related issues involve the ability of the Owner, especially in condo-hotel projects, to dictate and enforce room maintenance and FF&E standards as well as rental-related and hotel service related control issues. These are discussed in more detail below.

e. <u>Convert/Reposition Residential Product Type</u>. Although the decision to reposition the project is not a legal one, doing so will have legal implications. Troubled hospitality projects that include significant condominium or other residential components should be analyzed to determine whether the residential component should be downsized or eliminated altogether or converted to another product type such as hotel inventory or timeshare. In the face of COVID-19 and the impending down market, we are likely to see many uncompleted projects where the fair market values of the residential units have dropped below the purchase price for the units. Owners of these projects can expect that a significant number of purchasers will not close on the residential units due to the deflated purchase price and the inability to obtain purchase financing. Many Developers faced with this situation will, by necessity, convert the condominium units to hotel inventory or some other use.

(i) Also, due to declining RevPAR and occupancy levels, many Developers will temporarily or permanently scale back on the number of hotel and condo-hotel rooms to be developed in a project, with some even shuttering portions of their partially completed projects until the lodging industry picks up.

(ii) This analysis is highly dependent on the stage of development of the project. There may be little ability to change unit type and count in projects that are near completion. For example, expensive, multi-bedroom condominium units may not be as marketable as smaller, less expensive units.

(iii) For existing fractional and timeshare projects that are experiencing dismal sales, the fraction size should also be reviewed and a new or updated feasibility study should be prepared. Also, especially for foreclosing lenders, an analysis of the sold intervals should be made. Poor management of inventory sales, especially during poor sales periods, can lead to disastrous circumstances. For example, if the Developer and/or sales team are not efficient in consolidating the sales of the intervals into as few units as possible, the project may be saddled with a small number of sales spread among a large number of units. Or, in an effort to make as many sales as quickly as possible, the sales team may sell the prime inventory first, leaving behind hard-to-sell inventory that is spread among a large number of units. Situations such as these can severely limit the ability of the Developer/lender to reposition the fractional units. As an aside, lenders to fractional and timeshare projects should include strict covenants in the loan agreement that mandate the manner in which the intervals are sold (e.g., restricting the sales of intervals to a maximum number of units at any one time).

(iv) This section is applicable to mixed-use residential projects that do not currently have a timeshare program. However, conversion to timeshare certainly is something that should be considered. Below are some of the pros, cons and issues to be considered in connection with a potential timeshare conversion.

(a) What Are the Pros and Cons of Converting to Timeshares?

Pros: An alternative to weak condominium sales, the timeshare market may not be as weak as the condominium market. In addition, condominiums can usually be fairly easily converted to timeshare units, the timeshare program can be flexible to incorporate more units if demand dictates, timeshare presents another revenue source to offset weak condominium sales and inbound exchange users will present marketing opportunities for timeshare and condominium sales.

Cons: Timeshares may dilute a high-end brand image and timeshare sales may not be strong in the particular resort location. In addition, once the first timeshare interest is sold the regime is created and it may be hard to reverse course, and the Owner of the project will not be entitled a rental split as it would with condominium units. Finally, the Owner of the project may not have as much control over the timeshare program as it will over a condominium program.

(b) Can the Timeshare Units Be Sold in Bulk? Yes. The Owner may want to sell a block of units to a third-party timeshare developer. Doing so would enable the Owner to quickly dispose of a block of units and receive a known amount of proceeds, but the units would undoubtedly be sold at a deep discount.

(c) How Should the Timeshare Program Be Branded? The Owner will have to decide whether to brand the timeshare program the same as the hotel brand (if that is possible), affiliate with an established third-party brand, or create a new brand. A national brand has marketing advantages, but may require the Owner to give up significant marketing and management control.

(d) Who Should Manage the Timeshare Program? The program can be managed by the Manager or a third-party manager. The Manager usually is the better choice in order to maintain a cohesive project, especially if the Manager has timeshare experience or is affiliated with a multi-site timeshare program.

(e) Should a Feasibility Study Be Performed? Yes. Converting to timeshare is a significant undertaking and the Owner should obtain as much relevant information as possible to assist in the decision making process.

(f) Will the Timeshare Program Affect the Existing Project Structure? Yes. The existing project documents will have to be reviewed and revised to take the timeshare program into account. In addition, the Owner will need to determine whether timeshare is permitted or whether approvals will need to be obtained.

(g) What Documents Will Need to Be Prepared? The Owner will need to prepare project documents such as timeshare declarations, articles of incorporation, bylaws, rules and regulations, and reservation procedures; consumer documents such as purchase agreements, deeds, purchaser disclosures, public offering statements and rental agreements; and timeshare sales and

HMAs such as sales and marketing agreements, license agreements, timeshare HMAs, exchange agreements and OPC agreements.

(h) When Can Sales Commence? It depends on the state in which the project is located and is to be marketed. Typically, a timeshare permit is required from each state in which timeshare sales are to be solicited. The registration process varies from state to state, but typically it takes anywhere from three to nine months to obtain approvals, although some states will grant a preliminary approval that will allow timeshare sales to commence sooner.

(v) Clearly, if any of the project changes discussed above are implemented, a host of legal issues must be addressed. For example, project documents such as condominium declarations will have to be reviewed and revised, HMAs and license agreements will need to be renegotiated and revised, state and federal registrations may need be amended to reflect the project changes or change in the Developer (e.g., if the lender forecloses) and purchase agreements and other disclosures made to purchasers regarding the project will need to be reviewed to determine, among other things, whether any purchasers will have rescission rights. Also, any purchase agreements applicable to residential units located in any portions of the project that will be shuttered or converted to hotel inventory or timeshare will have to be terminated (if possible) or moved to other residential units (if possible).

(vi) Of course, as discussed above, when considering repositioning inventory, a full analysis should be made regarding the impact on rescission rights. Rescission rights might be an issue if the project documents and/or disclosures made in the purchase agreement and the offering statements do not allow the Developer the flexibility to make desired changes. Also, if the Developer or lender desires to move purchasers from one unit or interval to another, such a change cannot be made without the purchaser's approval, effectively giving the purchaser a veto right and leverage for demanding concessions.

XIII. ACQUIRING ASSETS WITH GAMING AND LIQUOR: HOW TO GAMBLE AND DRINK WITHOUT A LICENSE

A. GAMING LICENSES. In the context of evaluating distressed hotel assets, what makes a casino asset or hotel asset with a casino or gaming component different from the standard operating business and what role does the regulatory framework play in the sale and acquisition of such distressed assets? During the last economic downturn, one of the most surprisingly affected industries was the casino and gaming industry. For example, the Las Vegas economy, once thought to be impervious to the economic swings suffered by the rest of the country, saw gambling revenues fall for only the second time in the past forty years; the first being after 9/11 when gambling revenues dropped 1% in 2002 from 2001 and the second downturn commencing in 2008 when revenues dropped over 16.5% and continued to fall with 2009 being the worst year on record…until the advent of COVID-19 in 2020. This chapter is intended to include a list of the many regulatory issues applicable to the Owners trying to survive these dire times and those Investors or Developers who wish to invest in gaming assets that have become financially distressed. With respect to acquisitions, whether at the corporate level or the property level, the business and legal analysis for distressed casino or gaming assets will follow the same structure as set forth in *Chapter III: Recapitalizing Joint Ventures* and *Chapter V: Purchasing Troubled Hospitality Assets*; provided, however, casinos present some unique issues as set forth below.

1. Introduction. The predominant issue Investors will face in this economy is determining what casinos are worth in this economic environment. Once a relatively closed and monopolized market, the impact of today's economy has opened the door for entrepreneurs to make unprecedented offers for choice properties in Las Vegas. Current Owners who are faced with economic or financial distress must consider the best time to sell their casino, and that moment may be now, while they are attempting to negotiate with lenders, or later, when these companies will be more deeply indebted but may have bankruptcy protection. Either way, the distinguishing factor for these casinos is their valuation. Traditionally, gaming analysts valued properties based on historical earnings; however, such reliance (on historical data) works only where net revenue required to service the property's debt stayed the same or increased. With distressed casino assets, the likely scenario is that the casino's earnings are declining rapidly and therefore, the old approach is no longer accurate. From a macro level, this requires a lender to base its analysis on what the casino is able to generate going forward rather than how it performed in the past (when the economy wasn't as bad). Looking forward rather than backward means a lot of guesswork, with optimistic guesses from sellers and pessimistic ones from purchasers (and lenders).

2. Operational Issues.[8] Many casinos are interconnected with hotels and resorts with the same entity (or by subsidiaries of the owning entity) owning and operating both the hotel and casino and therefore, to the extent that the Investor is acquiring both the hotel and casino, the same issues raised in connection with the acquisition and management of a distressed hotel will frequently arise with the acquisition and ownership of a distressed casino. However, if the Investor intends to bifurcate the project and acquire only one of the two components, new issues must be considered by both the Owner and casino owner in order to ensure that all rights and obligations between the parties have been discussed and agreed upon in advance. For example:

   a. Owner's Rights. Upon the acquisition of a distressed casino or gaming asset (i.e., separate and apart from the acquisition of the existing hotel component), will the casino owner and/or

[8] This discussion will use Nevada law and the traditional casino model to illustrate the problems that all investors, and the regulators within such gaming jurisdictions, will face when considering an investment in distressed casinos or hotel-casinos.

operator have any ongoing obligations to the existing hotel, hotel operator or its owners and alternatively, what rights will the casino need granted by the hotel:

(i) Hotel room block rights;

(ii) Comps and discounts at the hotel;

(iii) Access to hotel amenities (spa, restaurants, bars, nightclubs and/or golf course) for guests of the casino;

(iv) Right to use guest data collected by the hotel in the ordinary course of business;

(v) Integration of the marketing and handling of preferred guests of both the hotel and the casino; and

(vi) Adequate protection in the event that the Owner takes action or fails to take action that would adversely affect the casino license.

b. Financial Analysis. The typical Las Vegas hotel and casino is owned and operated by the same entity (or by subsidiaries of the owning entity) which means that hotel revenues are likely intermingled with casino cash. To conduct the proper financial due diligence for a distressed casino asset, it is possible to separate the hotel and casino components for purposes of selling each component separately. However, allocating the revenue between components remains an issue because not only might the revenues be intermingled, but the hotel may intentionally be operated at a loss in order to attract customers and increase gaming revenues (thereby driving revenues for the entire project).

3. Acquiring a Distressed Casino.

a. Existing Casino Management Agreements. Is there an existing casino management agreement with the Owner/operator or an unrelated third-party operator and what is a new Owner's right to either terminate such casino management agreement or require the existing casino manager to remain the operator?

b. Transition to New Casino Owner and Prorations. If the prior casino manager is being terminated and/or the casino, under the ownership of the new Owner, will operate under a new name, what will the process be for changing the new chips out of the existing casino? (Such process and the new chips are to be approved by the applicable state gaming board or commission.)

c. Casino Equipment. What contracts will the new owner assume for the operation of the casino and for gaming equipment licensed or leased at the casino?

4. Delays in the Issuance of Licenses by the State Gaming Regulator. The highly regulated gaming industry can be the most troublesome and confusing aspect of an acquisition and Investors or Developers who are unfamiliar with the regulatory process can be blindsided with delays, closing conditions and lengthy investigations that could have a material impact on their initial strategy and/or investment target. With time being of the essence in the majority of transactions involving distressed hotel and casino properties, the state gaming regulations can cause closing delays and/or impose material obligations and conditions on the prospective purchaser; both of which may cause an Investor to re-evaluate acquiring a casino or gaming asset. State regulatory agencies govern the ownership and operation of casinos (and gambling generally) within each of the

jurisdictions that support legalized gambling and each state's regulatory framework involves a different licensing and approval process.

5. Regulatory Issues. The following are examples of the licensing issues which could delay an Investor from closing on a gaming asset:

   a. Who Is Required to Obtain Licensing or Suitability? The regulatory structure governing casino assets requires a license for the following:

      (i) The casino itself will need to be an approved venue for gaming operations; however, in the context of acquiring an existing casino, such approval, absent a material change in the physical structure of the project (i.e., casino, lodging and/or parking components) would be included in the regulatory authorities' approval of the transfer;

      (ii) The direct Owner (and certain employees, officers and directors) of the casino will need to be licensed prior to participating in any revenues of the casino or asserting any control over the operations of the casino. Typically, the owner entity must either be a publicly traded company or a Nevada-formed entity (varies by state);

      (iii) In addition to the licensure of the actual owner entity, if the acquisition is completed by acquiring stock or equity interests in a holding company of the owner entity, the acquiring entity actually acquiring the ownership interests ("Transferee") would be required to be found suitable together with (1) all affiliates of the Transferee that own, directly or indirectly, 10% or more of the ownership interests of the owner entity (collectively, "Entity Qualifiers"); (2) all officers, directors and "key personnel" (as determined by the Nevada Gaming Control Board (the "Board") in their reasonable discretion) of the Transferee and all respective Entity Qualifiers and (3) any other person or entity affiliated with the Transferee who is found to have "control"; and

      (iv) The entity operating the casino or any other form of gambling game and (1) its respective Entity Qualifiers; (2) all officers, directors and "key personnel" (as determined by the Board in their reasonable discretion) of the Transferee and all respective Entity Qualifiers and (3) any other person or entity affiliated with the Transferee who is found to have "control."

[Note: The licensing process involves one of the more rigorous investigative processes in the world.]

   b. Will the Method and Size of the Acquisition Trigger the Licensing Process? As a threshold matter, and in furtherance of the licensing overview previously discussed, the acquiring party must consider both the ownership structure and the proposed operating structure of the casino.

      (i) An acquisition of the fee title interest in a casino requires the transfer to be approved by the Nevada Gaming Control Commission (the "Commission") and the transferee to obtain a new license.

      (ii) Acquisition of the issued and outstanding stock or other ownership interests in the entity which owns the distressed casino and the casino license ("Licensee"):

         (a) Ownership of any interest in a privately held Licensee requires the acquiring party to notify and be found suitable by the Commission; and

         (b) Ownership of more than 5% of a publicly held Licensee requires the acquiring party to notify the Commission, but no approval is required by law or statute, and ownership of more than 10% of a publicly held Licensee requires the acquiring party to be found suitable by the Commission.

Notwithstanding anything to the contrary, the Commission has the right, in its reasonable discretion, to require approval and/or licensure of any gaming transaction.

c. Structuring to Avoid or Reduce the Scope of the Licensing Process. There are options available to an Investor or Developer which can reduce the scale of the regulatory investigation and/or scope of the licensing requirements. These are critical, as today's casino ownership environment includes an influx of investment banks, hedge funds and other private equity sources which cannot subject all of their Investors to a rigorous and intrusive investigative process. Examples of these options are:

(i) Utilizing what the gaming industry commonly refers to as a "Vote-Co" structure by separating the voting and non-voting shares of the Transferee and creating Vote-Co to hold all voting shares. This allows the Transferee to make the argument to the regulators that all "control" rests in the Vote-Co entity and therefore, only Vote-Co and its officers, directors and key personnel should be subject to the licensing or suitability findings.

(ii) Utilizing a lease agreement (e.g., triple-net lease) between a licensed operator and the Transferee with specific provisions establishing fixed rent and granting the operator sole control over the casino operations.

While neither of the examples set forth above is guaranteed to eliminate or reduce the scale of the regulatory investigation and/or scope of the licensing requirements, each argument can be made in good faith and may serve as the Transferee's best option for surviving the regulatory process and facilitating an acquisition of distressed gaming assets.

d. Will the Proposed Transaction Be Able to Close in Lieu of the Final Approval of the Gaming Board and Gaming Commission? While each jurisdiction has broad discretion over approving and placing conditions on the closing of such transfers or acquisitions, as a general rule, the obligation to obtain licensure or a finding of suitability is not a condition precedent to closing; however, some jurisdictions will require the acquiring party to obtain its license before appointing anyone to the board of such Licensee or otherwise participating in any decisions regarding gaming.

6. Chapter 11 Bankruptcy. Like other sectors of the economy, distressed casinos have the option to seek federal bankruptcy protection in order to restructure debt and financial operations. A Licensee filing any petition with a bankruptcy court (or having such a petition involuntary filed against it) or having a receiver appointed for the casino or, in the event an assignment of the casino is made for the benefit of creditors, the licensed owner, trustee, receiver or assignee, as the case may be, shall immediately notify the Board of such fact in writing. A trustee, receiver or assignee must be authorized by the Commission in order to operate the casino during such time; provided that Nevada has allowed a trustee to use an existing casino license, with the caveat that the trustee must file an application and have it approved prior to operating the casino.

7. Foreclosure in the New Economic Environment.

a. The acquisition of distressed casino assets through foreclosure proceedings involves the same issues discussed above in that the new owner must be authorized by the Commission to operate the casino. The purchaser can enter into an agreement with the previous Owner to continue operating the casino during the interim period between acquisition and licensing, appoint a trustee who has been licensed by the Commission to operate the casino during the interim period, or enter into a third-party HMA with a new licensed operator for such interim period.

b. A possible new development that may be created by the anticipated economic climate is that lenders, who have avoided foreclosure on a casino property because many banks and other lenders had no interest in going through the lengthy and burdensome licensing process, may be overwhelmed with borrowers in danger of defaulting on their current debt service obligations. Thus, a significant number of lender groups, especially banks, may look to take ownership in distressed casino companies. Because many casinos are highly leveraged and there are few cash purchasers in today's market, ownership by a lender may become the best option for lenders to recoup their investment over time.

8. Public Policy. State regulatory boards have the task of protecting the gaming industry as a whole as well as policing the actual license holders and qualifiers. Therefore in today's environment, with cities like Las Vegas and Atlantic City depending on the tax revenue generated by casinos, the commissions may be more than willing to use their discretion to make changes or waivers in order to protect the industry and facilitate transactions that will ensure the continued operation of casinos.

B. LIQUOR LICENSES. The acquisition of distressed debt or assets in the hospitality sector commonly includes the purchase of an operating business that holds a retail liquor license and upon any such acquisition of a distressed hotel property or the debt associated therewith, the purchaser must ensure that all of the businesses involved with the sale of liquor continue to operate with a valid license. Therefore an acquiring person or entity must obtain or transfer, as applicable, a license for the premises and also for the operator (collectively, the "Liquor Licenses").

1. Alternative Solutions. Does the timing of the transaction prevent the purchaser from obtaining either one or both of the requisite Liquor Licenses? If the proposed acquisition of the distressed hotel asset will close prior to the purchaser obtaining all applicable permits and Liquor Licenses necessary for the continued liquor operations, or the jurisdiction in which the property lies has a finite number of licenses and the purchaser will be unable (regardless of time) to obtain such license and/or permit, the purchaser may consider the following alternatives:

   a. Interim Operating Agreement with transferor;

   b. Third-Party Operating Lease; and

   c. Third-Party HMA.

2. Licensing Process. What is the licensing process? For purposes of this analysis, the laws of the State of California Department of Alcoholic Beverage Control (the "ABC") will govern, and under applicable legislation (the "ABC Act"), any transfer of a retail liquor license is subject to ABC approval. Please note that liquor laws vary widely by state, and counsel should be consulted in connection with any licensing process.

3. Property Acquisition. In the event that a property is acquired that already has an existing liquor operation and is licensed as an approved location (the "Licensed Premises"), the following filings may be required to effect a "person-to-person" transfer (i.e., the existing license for the premises to operate as an approved location is transferred to the new acquirer):

   a. Escrow must be opened;

   b. Notice of Intended Transfer (Form 227);

c. Application for Alcoholic Beverage License (Form 217) signed by officers;

d. License Transfer Request (Form 211-A) signed by two officers of the transferor, which is used both for the transfer of the retail license and for the application for a temporary permit that allows the transferee to operate if the parties have agreed that the transferee may temporarily operate the business pending completion of the ABC's investigation and report; provided, however, neither the transferor or transferee shall be required to file a License Transfer Request in the event the transferee acquires the shares of the former licensee; and Property Qualification documents in the event that the premises has not been operated under a liquor license for 90 days prior to the transferee's filing of its liquor application:

(i) Zoning Affidavit (Form 255) and

(ii) Diagram of Licensed Premises (Form 257);

e. Statement re Consideration Deposited into Escrow (Form 226) furnished to escrow holder; and

f. Affidavit of Posting (Form 293) filed with the ABC within five days after posting; and Affidavit of newspaper publication of notice filed with the ABC after publication.

Notwithstanding the person-to-person transfer, the acquiring person and/or entity is still subject to applying for and obtaining a valid liquor license to operate the Licensed Premises.

4. <u>Acquisition of Ownership Interests</u>. In the event that the Investor acquired the distressed asset by purchasing an ownership interest (i.e., stock, membership interests or partnership interests) in the transferor (as opposed to title to the real property), the following filings may be required to effect a "person-to-person" transfer of the existing liquor license held by the Licensed Premises (provided that the acquiring person and/or entity is still subject to applying for and obtaining a valid liquor license to operate the Licensed Premises):

a. Corporate/LLC/LP Questionnaire (as applicable);

b. Certification — Tied House (Form 140);

c. Articles of Incorporation/Organization or Partnership Agreement;

d. Stock register and copies of share certificates;

e. Minutes of appointment of managers, members or officers and directors (as applicable);

f. Notarized Personal/Financial Affidavits (Form 208A/B) as required based on type of entity;

g. Corporate Questionnaire (Form 243) for transferee and its parent entities (with all supporting documentation submitted above); and

h. All individuals listed as licensees on the license.

5. <u>Qualifying Entities for a License</u>. As discussed above, upon the acquisition of the distressed hospitality assets contemplated herein, the new owner will need to be licensed by the ABC in order to operate any liquor sales at the property. Similar to casino licensing, the ABC generally requires qualification documentation for the entity named on the license and the particular individuals and related entities with specified relationships to the proposed licensee. In California, the ABC

requires qualification of various officers, directors, management personnel and owners who own 10% or more of the entity.

a. General Partnership. All general partners must be approved and the ABC will issue the license to the partners themselves and not to the general partnership;

b. Corporation (Private). Certain stockholders, officers and directors as may be required by the ABC; or

c. Limited Liability Company. If the LLC is member-managed, all members must be qualified; provided, however, if the LLC is managed by a manager, only the manager and any member with 10% or more of the voting interests of the company must be qualified, as well as any LLC in the chain of ownership with a 10% or more ownership.

XIV. RE-OPENING AND OPERATING IN THE POST COVID-19 WORLD

A. RETURNING TO WORK. As the country begins to lift social distancing and stay-at-home orders, employers are confronted with the task of safely resuming business operations while protecting both consumers and employees in the transition. We can assume that all types of businesses closed during the COVID-19 crisis will eventually be allowed to re-open, but the how and the when will look dramatically different from pre-pandemic norms. As previously discussed, employees will want confirmation and guarantees that, under OSHA regulations, their workplace is safe and hazard-free. Failure of employers to properly protect their employees in the post-pandemic workplace is an invitation for claims brought by employees or OSHA itself. It's important to remember that the threat has not disappeared; therefore, preparing to return to work means that our "new normal" must include active protective measures for employees. Closely following the CDC guidelines and recommendations, as well as re-opening only per jurisdictional orders, should help mitigate the risk of claims against employers.

B. TORT AND CONSUMER LIABILITY EXPOSURE UPON RE-OPENING. Hotels may face tort claims related to exposure to COVID-19 after their reopening. We already have discussed potential exposure to hotel employees. There also may be exposure to claims asserted by guests. The types of claims each hotel might face may depend on where they are located, as tort law varies state-by-state.

1. Due Care for Guests. While the type of claims may be described differently, hotels should expect that they will need to meet various standards of care for their guests with respect to COVID-19 exposure. These burdens should not be new to hotels as they bear these burdens now. They should expect it would be argued that they owe a duty of due care to their guests to take reasonable steps to reduce the potential for harm from pathogens. What will be different is the steps necessary to meet the standards. Hotels will need to understand that COVID-19 may increase their obligations with respect to the protection of their guests and those increased obligations will have practical impacts on issues like access to and spacing in the common area, use of elevators, check in and check out procedures, as well as cleaning schedules.

2. Will the Duty of Care Stay the Same? No. Hotels will need to understand that while they should implement best practices, duties are dynamic. As the facts in a specific hotel and a specific locale change, so should the hotel's attention to its safety practices. If a hotel learns that an employee has COVID-19, it is likely it will need to take certain additional responsive steps with respect to existing and future guests. If a hotel learns that a guest has had COVID-19, it is likely it will need to take certain additional responsive steps with respect to existing and future guests. If a hotel learns that there has been a surge in infections in its locale, it is possible that additional cleaning regimes will need to be implemented. The point is that hotels should not assume that its current response plan will be the only response plan and remain static without subsequent changes, and hotels will need to plan to be proactive and reactive, quickly, and in real time. The duties will change as the facts change.

3. Where Do the Duties Come From? Tort duties historically come from the common law, which means that there is no written statute or check list. The standards emerge as cases are litigated. In the more modern era, the case-by-case approach remains true. Duties are also now measured against industry standards, both published and unpublished. Duties may also be measured against local, state, and federal guidance. Thus, recommendations coming from OSHA, the CDC, or other regulators may themselves be evidence of the standard of care. Hotels should remember, however, that published standards are not necessarily defenses and compliance will not insulate an owner or manager from potential liability. Depending on the specific facts, a higher duty may be present than any specific guidance suggests. Likewise, given the variety of services offered in a hotel, a hotel may be subject to multiple, differing types of guidance – e.g., guidance as to salons; guidance as to pools; guidance as to retail sales, etc.

4. What Is the Exposure? While the damages available in each state will differ, generally tort damages allow for compensatory damages. Broadly described, tort damages are intended to compensate for the injury sustained, inclusive of medical costs, lost work, and other damages that compensate for the injury sustained. States will differ on whether and how they allow compensation for pain and suffering. Some states will also allow for the recovery of punitive damages if the steps taken, or not taken, leading to plaintiff's injury rise to a certain level of wrongfulness, which is normally higher. Some states do not allow for punitive damages, or cap the punitive damages that may be awarded in relation to the compensatory damages proven.

5. Who Else Can Sue the Hotel? Because hotels are the place of meetings, meals, and shopping, the potential exposure to claims will not be limited to overnight guests. Instead, general rules of premises liability and invitee liability will apply. That law, too, differs by state, with some states differing between invitees, licensees, and trespassers. Generally, however, it may be prudent for hotels to assume that the standard of care will extend to all individuals they can foresee coming to the hotel. States also differ in their approach to exposure to employees of independent contractors (e.g., the employee of vendor plumber). Some states allow for a broad range of independent contractor suits while others allow for a narrower range. Likewise, some (but not all) states allow for what is sometimes describes as "take home" liability, extending exposure to those who take the pathogen home.

6. How Else Can Guests Sue? Our discussion thus far has focused on tort claims (negligence, battery, etc.) that guests may bring against hotels. But many states also have consumer protection statutes allowing for differing types of remedies. Some of these consumer protection statutes make actionable a violation of some other law or regulation. They "borrow" the regulatory regime and allow a private litigant to enforce the claim. Still, other consumer protection statutes make marketing actionable. Hotels may intend to market the steps they are taking to respond to the COVID-19 crisis and guest concerns only to see those ads invoked in a consumer protection claim alleging a misrepresentation or omission. Similarly, as was true for the initial shut down orders, hotels will need to consider how they respond should future stays become impossible because of the evolving COVID-19 landscape. Thus, claims may be brought in tort, but they may also be brought based on statutory theories, contract theories, and they may seek to represent multiple guests in a class action. Hotels should therefore be thinking holistically about their exposure to guests. This thinking should analyze the hotel's continued solicitation of patrons (marketing), their experience while at the hotel, and what happens if the stay becomes impossible. Each step can lead to unique and differing claims.

7. Can a Hotel Cap its Liability or Obtain a Waiver? With the uncertainties about how the COVID-19 crisis will unfold, hotels may also be considering whether they can get guests to waive claims in advance. The answer to this issue is complicated. States have differing rules about what claims can be waived in advance. Some states allow for advance waivers rather easily while others have more onerous requirements. Generally, where advance waivers are allowed, they are permitted as to negligence claims but not as to gross negligence or intentional tort claims. Some states are more solicitous of waivers in contracts of adhesion while others are not.

8. Are There Defenses to Claims? Yes. Hotels who follow best practices can show they did not breach applicable standards of care will not invariably be held liable just because a guest becomes ill. Likewise, given the prevalence of COVID-19 in the community, it may be impossible for a particular plaintiff to prove causation (typically a necessary element). The discussion above is intended, instead, to flag where exposure may lie so hotels can plan accordingly.

C. THINGS TO CONSIDER. As you are preparing to resume or ramp up operations, there are many strategies that should be considered to ensure the safety of both your employees and guests. In addition, in all aspects, employers should ensure continued compliance with other employment laws outlined in

Section I above, including paid and unpaid leave obligations, FMLA, and wage and hour laws. The checklist attached as Annex D can guide a hospitality business through the re-opening steps.

1. With Respect to Your Employees:

    a. Consider implementing an employee testing protocol. Pursuant to guidance from the EEOC, under current circumstances, employers may institute a policy of (i) testing all employees for COVID-19, (ii) checking all employees' temperatures, and/or (iii) asking employees whether they have symptoms of COVID-19, before allowing an employee to return to the workplace. However, all medical information, including test results, must be kept confidential. If an employee refuses to submit to tests, or acknowledges or displays symptoms of COVID-19, the employer may send that employee home and bar them from returning to the workplace. An employer may also condition the employee's return to work upon receipt of a doctor's note certifying that the employee is fit to return to work.

    b. Instruct employees to notify their supervisors or managers immediately if they are aware of a fellow employee or a guest with symptoms.

    c. Require all employees to wear a face mask while at work to reduce the risk of transmission.

    d. Train all employees regarding the importance of frequent handwashing and provide employees with hand sanitizer for regular use. Establish social distancing protocols applicable to employees, including separating workstations at check-in desks by six feet or more.

    e. Train housekeeping and maintenance employees regarding protocols for enhanced cleaning and disinfecting of guest rooms and common areas. Disinfecting protocols should focus on non-porous, high-touch surfaces. In common areas, this would include check-in counters, elevators and elevator buttons, door handles, public restrooms, vending and ice machines, ATMs, and escalator and stair handrails, and most surfaces in any fitness centers (water fountains should be closed). In guest rooms, this would include door handles, light switches, television remote controls, toilet seats and handles, faucet handles, telephones, temperature control panels, and alarm clocks.

2. With Respect to Your Guests:

    a. At check-in, inquire as to whether a guest would like housekeeping services provided for in their room, as some guests may prefer to reduce staff presence in their room.

    b. Provide hand sanitizer for guest use, preferably using contact-free dispensers.

    c. Implement social distancing requirements: (i) utilize floor markers at check-in desks and other que areas to remind guests to remain six feet apart; (ii) re-configure lobby furniture to encourage proper distancing; (iii) consider restricting the number of guests who may ride in an elevator simultaneously; and (iv) limit the number of patrons who may utilize certain areas, such as fitness centers or hot tubs, at one time.

    d. Frequently contact guests to identify any service or medical attention needs, and offer access to a hotel physician if available.

    e. Reduce direct contact between employees and guests: (i) implement contact-free delivery of any room service; (ii) erect plastic barriers between staff and guests at check-in desks; and (iii) where possible, discontinue valet services.

f. In the event of a presumptive or confirmed case of COVID-19, advise the affected guest to limit contact with others and seek medical treatment as necessary, and notify the local health authority. Contain and secure rooms impacted by the symptomatic guest (i.e., prohibit access, reduce cleaning frequency to "as needed" until vacancy or self-isolation period is complete, offer clean linens, towels, and amenities on a regular basis, direct engineering teams to implement measures to isolate HVAC systems for impacted rooms and areas). Once vacant, the room should not be returned to service until an enhanced disinfecting is performed, consistent with CDC guidelines.

g. Warn other prospective guests of any confirmed COVID-19 cases at the hotel at check-in with the option to leave or cancel reservations without penalty.

3. <u>Establishments with Restaurants Must Also Take Precautions with Respect to Re-Opening Dining Spaces</u>:

   a. Prevent congregation of patrons. Utilize floor markers at the host desk, in the que for any buffet service, and outside single occupant restrooms to remind patrons to que six feet apart. Consider transitioning to a reservation-only system to prevent congregation of guests waiting to be seated.

   b. Avoid the use of buffet-style food service. If a buffet must be utilized, take steps to mitigate the risk of COVID-19 transmission: (i) use a barrier over food displays to prevent contamination from coughs or sneezes; (ii) designate staff wearing PPE to serve guests at buffet stations, or, if not feasible, frequently sanitize serving utensils; (iii) remove unwrapped straws from self-service drink stations; and (iv) stock buffet stations to minimal levels to minimize food being exposed for long periods.

   c. Fully disinfect tables and chair handles between each guest seating using products approved for the eradication of COVID-19. Minimize items on dining tables, such as condiments or flowers, to allow for complete and efficient disinfection between guests.

   d. Increase the distance between guest tables to six feet or more. Where possible, consider expanding use of outdoor seating to provide necessary distance.

   e. In lieu of bars, provide table-only service of alcoholic beverages.

   f. Ensure proper air filtration and conduct regular cleanings of HVAC intake systems.

4. <u>Limit Risk</u>. There are a number of things that employers should consider implementing in order to limit litigation risk that will undoubtedly flow from COVID-19-related incidents: (i) comply with public health and safety standards; (ii) maintain documentations and data through proper record keeping to later establish the guidance was required and the procedures were actually implemented; (iii) be aware of disclosure obligations and consumer protection laws, such as required disclosures to guests of a positive test; (iv) consider a waiver of negligence from guests, which varies by state; and (v) consider requiring guests arbitrate any claims of possible exposure to COVID-19 and waive the right to bring any class action claim.

XV. ANNEX A: 50-STATE SURVEY OF STATEWIDE COVID-19 BUSINESS CLOSURES

Key:

Pink	=	shelter in place or equivalent
Yellow	=	state-wide closures of specific businesses
Green	=	no meaningful statewide response

Last Update Finalized: 05/04/2020 @ 4:00 PM PT
(reviewed and updated all 50 states, which are each current as of the time indicated)

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Alabama	3/20/2020 Executive Order - No shelter in place, but statewide restriction of all non-work related gatherings (public gatherings, dine-in at restaurants, schools, beaches). No public gatherings of over 25 people & must conform to 6-feet distancing. 3/24/2020: Governor mentioned no plans for a statewide shutdown. 3/28/2020: Executive order with substantial list of retail/entertainment businesses that must close 4/03/2020: Executive order mandating full stay at home order, preempts local orders while in effect	All non-essential businesses closed Shelter in place order expired on April 30, 2020	3-Apr	5-Apr	https://governor.alabama.gov/assets/2020/04/Final-Statewide-Order-4.3.2020.pdf
Alaska	**3/18/2020** Executive Mandate - No shelter in place, but statewide restriction of public gatherings (schools, state-operated facilities, dine-in restaurants). Localized closures of certain businesses. **3/23/2020** -- all businesses, congregations, or gathering where individuals are within six feet of each other must stop all operations (includes personal care services) and no gatherings of 10 more people may take place. All people arriving in Alaska, whether resident, worker or visitor, are required to self-quarantine for 14 days, starting 3/24/2020. **03/28/2020 -** Executive Mandate for statewide shelter in place, closes all non-essential businesses, Minimum Basic Operations exception, preempts local orders	Statewide shelter in place but for essential businesses		5-Apr	https://content.govdelivery.com/accounts/AKDHSS/bulletins/283a713

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Arizona	**3/19/2020** - No shelter in place, but statewide closure of restaurants, bars, theaters, and gyms in counties with confirmed COVID-19 cases. Statewide school shutdown. Recommended to not gather with 10 or more people. Schools closed through 4/10/20. **3/23/2020** - Executive Order essentially delegates stay at home orders to cities/counties/towns. Order states that that no county, city, or town may issue an order that restricts any person from performing a function designated as an essential function. **3/31/2020** - Statewide stay at home order, all non-essential businesses must close **4/03/2020** - Guidance on essential businesses: https://azgovernor.gov/governor/news/2020/04/additional-guidance-essential-services **4/29/2020** – Governor announces extension of stay-at-home order with less restrictive terms through May 15, 2020	Additional guidance	5-Apr	5-Apr	https://azgovernor.gov/sites/default/files/eo_2020-18_stay_home_stay_healthy_stay_connected_1.0.pdf
Arkansas	**3/20/2020** - No statewide closure, but statewide closure of schools, gov't employees will work at home unless on-site job is a necessary function, no dine-in at restaurants/bars, closed gyms/indoor entertainment venues			5-Apr	https://www.healthyarkansas.com/images/uploads/pdf/Directive_03.19.2020_final.pdf
California	Statewide "stay at home" order – N-33-20 - Stay at Home order, essential businesses list incorporates CISA, Additional sectors of industry may be designated (check site for most up to date list). Does not supersede local orders that impose stricter limitations. **3/22/2020** - President Trump approved Governor Newsom's request for a presidential Major Disaster Declaration. **3/23/2020** - The PH Enviro alert published this morning suggests that the Governor's office is reconsidering whether the statewide order supersedes more stringent local orders. (California State Public Health Officer & Director of the California Department of Public Health, California Coronavirus (COVID-19) Response Frequently Asked Questions (as of Mar. 24, 2020) (Response to the question "How does this order interact with local orders to shelter in place? Does it supersede them?" previously stated that more stringent local orders would control, but now states only that this "is a statewide order.").			5-Apr	https://covid19.ca.gov/ (links to FAQ, list of businesses, and order)

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
	3/23/2020 - LA Mayor Garcetti announced stronger enforcement of Safer At Home Order				
Colorado	**3/19/2020** - Executive Order statewide closing schools; closing restaurants, theaters, gyms, casinos, and other nonessential personal services facilities; and restrictions to nursing facilities **3/25/2020**--Effective, Thursday, 3/26, Executive state-wide Order directing all Coloradans to stay at home, subject to limited exceptions such as obtaining food and other household necessities, going to and from work at critical businesses, seeking medical care, caring for dependents/pets, or caring for a vulnerable person in another location. All businesses other than those qualified as "critical businesses" to close temporarily, except as necessary to engage in minimum basic operation needed to protect assets and maintain personnel functions. "Critical businesses" include healthcare operations, critical infrastructure, critical manufacturing, critical retail, critical services, news media, financial institutions, providers of basic necessities to economically disadvantaged populations, construction, defense, services necessary to maintain safety and sanitation of residences, critical government functions.	Stay at home order lifted (expired on April 26, 2020)		5-Apr	https://covid19.colorado.gov/
Connecticut	**3/20/2020** – Executive order, statewide closure of all non-essential businesses FAQs available at: https://portal.ct.gov/-/media/Coronavirus/COVID-19-FAQs.pdf?la=en (last updated 3/23 @ 10:00 PM local time)			5-Apr	https://www.courant.com/coronavirus/hc-news-coronavirus-update-0320-20200320-m5oro7ss3vb3nlqsormcmt6nty-story.html

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Delaware	**3/22/2**020 - Executive Order. Shelter in place, other than essential businesses and minimum basic operations as defined in this order and the preceding order. Full list of essential businesses can be found at: https://coronavirus.delaware.gov/wp-content/uploads/sites/177/2020/03/Delaware-list-of-essential-and-nonessential-businesses-March-22-2020-1.pdf **4/04/2020** - news reports of significantly increased enforcement		5-Apr	5-Apr	https://governor.delaware.gov/wp-content/uploads/sites/24/2020/03/Fifth-Modification-to-State-of-Emergency-03222020.pdf
District of Columbia	**3/25/2020** - Mayor's Order. Shutdown of all non-essential businesses, prohibition on large gatherings.			5-Apr	https://coronavirus.dc.gov/sites/default/files/dc/sites/mayormb/release_content/attachments/Mayor%27s%20Order%202020-053%20Closure%20of%20Non-Essential%20Businesses%20and%20Prohibiti....pdf;
Florida	**3/20/2020** - Executive Order: No statewide shutdown, but statewide restrictions including closures of dine-in restaurants and bars. Closure of gyms and fitness centers, unless they are amenities of hotels w/ capacity of 10 people or less, are an amenity of a residential building, are interior to any fire/police station, or are located inside a single-occupant office building **3/23/2020** - Order all visitors, residents, workers flying into the State from an area with substantial community spread must quarantine for 14 days or for duration of presence in state, whichever is shorter. **3/24/2020**--Executive order directing surgeon general to issue health advisory: (1) to all persons over 65 years of age urging them to stay home; (2) to people w/ serious underlying medical conditions urging them to stay home; (3) against all social gathering of 10 or more people; (4) urging all people who can work remotely to do so; **3/31/2020:** shelter in place order issued **04/02/2020**: Preempts all local orders	Shelter in place order to be lifted on May 4, 2020 (except in Miami-Dade, Broward and Palm Beach counties)	2-Apr	5-Apr	https://floridahealthcovid19.gov/news/
Georgia	**3/23/2020**--executive order effective 3/24, all people at high risk of contracting COVID-19 must self-quarantine for 14 days, all bars and nightclubs will close, and no gathering of 10 or more unless the participants remain 6 feet apart. **4/2/2020** - Executive order with state wide stay at home **4/3/2020** - updated definitions of essential businesses	Expanded definition of essential services Stay at home order lifted (expired April 30, 2020 – restrictions still in place for vulnerable	5-Apr	5-Apr	https://gov.georgia.gov/executive-action/executive-orders/2020-executive-orders

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
		Georgians and businesses (i.e., elderly and medically fragile must continue through June 12, 2020)			
Hawaii	**3/23/2020**: Stay at home order issued, effective 3/25.	Stay at home order extended to May 31, 2020		5-Apr	https://dod.hawaii.gov/hiema/supplementary-proclamation-covid-19/
Idaho	**3/25/2020**: State-wide stay-home order issued. Requires citizens to self-isolate, excluding healthcare, public safety, grocery stories, news media, gas stations, among others. Effective immediately and will remain in effect for 21 days.	Stay home order lifted (expired April 30, 2020)		5-Apr	https://coronavirus.idaho.gov/wp-content/uploads/sites/127/2020/03/statewide-stay-home-order_032520.pdf
Illinois	**03/20/2020** - State-wide stay at home. Gatherings of more than 10 people prohibited. All non-essential businesses closed. FAQ's available at: https://www2.illinois.gov/sites/coronavirus/FAQ/Pages/Stay-At-Home-FAQS.aspx Exceptions: Leaving home for safety (such as to avoid domestic violence); For necessary supplies or services, such as groceries and sanitation; For outdoor activity, with proper social distancing; or To care for others or to transport others. Essential businesses are: Healthcare and public health operations, human services operations, essential government functions, and essential infrastructure (groceries, pharmacies, media, social services, financial services, hardware/supply, gas stations, mail, laundry, restaurants for take-out.	Stay at home order extended to May 30, 2020		5-Apr	https://www2.illinois.gov/Documents/ExecOrders/2020/ExecutiveOrder-2020-10.pdf
Indiana	**3/23/2020** Executive Order: Shelter in place order issued, ordering residents to stay at home other than essential businesses and activities: Essential businesses and services include but are not limited to grocery stores, pharmacies, gas stations, police stations, fire stations, hospitals, doctor's offices, health care facilities, garbage pickup, public transit, and public service hotlines such as SNAP and HIP 2.0. A list can be found in the Governor's executive order at in.gov/coronavirus. Essential activities include but are not limited to activities for health and safety, necessary supplies and services, outdoor activity, certain types			5-Apr	https://www.in.gov/gov/files/Executive_Order_20-08_Stay_at_Home.pdf

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	of essential work, and to take care of others. A list can be found in the Governor's executive order at in.gov/coronavirus. **5/01/2020** – Governor announced plans to replace statewide stay-at-home order with less stringent requirements.				
Iowa	**3/17/20** Executive Order: No shelter in place, but bars, restaurants, gyms, night clubs, schools closed statewide. **3/24/20** News Report: Governor says shelter in place "still not needed," despite increasing pressure from various localities to so order. **3/25/20** News report: Governor says state is under "equivalent" of "informal" stay at home order			5-Apr	https://idph.iowa.gov/News/ArtMID/646/ArticleID/158309/Gov-Reynolds-issues-a-State-of-Public-Health-Disaster-Emergency-31720
Kansas	**3/17/20** Governor's Order: Schools closed for the rest of the school year. **3/28/20** Governor's Order: "Stay at home" order limiting to Essential Activities and essential businesses defined as "KEFF" Kansas Essential Function Framework. Preempts all local orders while in effect.	Stay at home ordered, effective Monday Preempts local orders		5-Apr	https://governor.kansas.gov/wp-content/uploads/2020/03/EO-20-14-Executed.pdf https://governor.kansas.gov/wp-content/uploads/2020/03/EO-20-15-Executed.pdf https://governor.kansas.gov/wp-content/uploads/2020/03/EO20-16.pdf
Kentucky	**3/25/2020** Executive Order: Only essential businesses permitted; non-essential retail businesses ordered closed that are not considered "life sustaining." Adopts CISA list among other categories. All elective medical procedures ordered to cease. No shelter in place. All mass gatherings prohibited (defined as any event or convening that brings together groups of individuals).	All non-essential businesses closed Tentative re-opening schedule announced	28-Mar	5-Apr	https://governor.ky.gov/covid-19-response https://governor.ky.gov/attachments/20200325_Executive-Order_2020-257_Healthy-at-Home.pdf
Louisiana	**3/22/20**: All non-essential businesses closed. Largely adopts the CISA guidance for exemptions. Also excludes food, medicine, and other similar goods necessary and non-elective medical care and treatment and other similar vital services Does permit minimum basic operations, broadly defined.	Stay at home order extended to May 15, 2020		5-Apr	Order: https://gov.louisiana.gov/assets/Proclamations/2020/JBE-33-2020.pdf Essential businesses guidance: https://gov.louisiana.gov/assets/docs/covid/Essential-Infrastructure_fact-sheet.pdf

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Maine	**3/24/20**: Effective 3/25, statewide shutdown of non-essential businesses. No shelter in place order, but stopped "just short." **3/25/20**: FAQs available here: https://www.maine.gov/governor/mills/sites/maine.gov.governor.mills/files/inline-files/FAQS%20-%20Business%20Closures%20Executive%20Order%20Number%2019%20V2_0.pdf **3/31/20**: full shelter at home order limiting activities as well as further limitations on businesses	Full shelter at home order extended to May 31, 2020		5-Apr	https://www.maine.gov/governor/mills/covid-19 https://www.maine.gov/governor/mills/news/governor-mills-issues-stay-healthy-home-mandate-2020-03-31
Maryland	**3/23/20:** All non-essential businesses ordered to close. Specifically: "All Marylanders are urged to remain home, and employers are urged to promote work-from-home arrangements to the greatest extent possible," although guidance notes it is "not a shelter in place" order. Critical Infrastructure Businesses are not required to close, modeled after CISA and emphasized as "non-exhaustive." **3/30/2020:** Stay at home added on	Stay at home in addition to closing businesses	31-Mar	5-Apr	https://governor.maryland.gov/wp-content/uploads/2020/03/Gatherings-FOURTH-AMENDED-3.30.20.pdf https://www.docdroid.net/hqOjrmf/olc-interpretive-guidance-covid19-04.pdf
Massachusetts	**3/23/20**: All non-essential businesses ordered closed. Details on non-essential businesses issued and available here: https://www.mass.gov/info-details/covid-19-essential-services	Stay at home order extended to May 18, 2020		5-Apr	https://www.mass.gov/news/governor-charlie-baker-orders-all-non-essential-businesses-to-cease-in-person-operation; https://www.mass.gov/info-details/covid-19-essential-services
Michigan	**3/23/20**: Shelter in place order announced, largely tracking federal guidance and citing to CISA. Exemptions for critical infrastructure workers defined in executive order. If not part of a defined exemption, employees must be affirmatively "designated by their employers" as such worker, in writing (although oral communication allowed until March 31).			5-Apr	https://www.michigan.gov/whitmer/0,9309,7-387-90499_90705-522626--,00.html
Minnesota	**3/25/20**: Statewide stay at home order, shutdown of non-essential businesses.	Stay at home order extended to May 18, 2020		5-Apr	https://mn.gov/governor/covid-19/covid-news.jsp?id=1055-424820
Mississippi	Statewide shutdowns: All public schools closed through 4/17/20; State agencies allowed to send home all non-essential employees; Businesses "encouraged" to send home all non-essential employees; all non-essential employers must limit gatherings to less than 10 **3/26/2020**: In a press conference Governor Reeves said if health or federal officials ask for him to issue a stay-home order, he will "be willing and able to implement it."	Statewide shelter lifted (expired April 27, 2020 – Safer at Home order with relaxed restrictions now in place until May 11, 2020)	2-Apr	5-Apr	Executive Order No. 1460: https://www.sos.ms.gov/Education-Publications/ExecutiveOrders/1460.pdf Executive Order No. 1458: https://www.sos.ms.gov/Education-Publications/ExecutiveOrders/1458.pdf https://www.sos.ms.gov/Education-Publications/ExecutiveOrders/1466.pdf

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	3/31/2020: Shelter in place for Lauderdale county **4/02/2020**: statewide stay at home, no gatherings over 10 people, non-essential businesses close				
Missouri	**3/23/20**: Order from Director of the Dept. of Health and Senior Services • Requires social distancing, avoid social gatherings over 10 people. • No eating or drinking at restaurants, bars, or food courts. • No visiting nursing homes, long-term care facilities, retirement homes unless providing critical assistance • Schools remain closed **4/03/20**: all non-essential businesses closed, adopts CISA guidance, other restrictions	All non-essential businesses closed Re-opening plan goes into effect May 4, 2020 until May 31, 2020	3-Apr	5-Apr	https://content.govdelivery.com/attachments/MOGOV/2020/04/03/file_attachments/1419322/Stay%20at%20Home%20Missouri%20Order.pdf
Montana	**3/27/2020** – Governor issued stay-at-home order effective March 28, 202 until April 10: • All individuals stay at home except for essential activities or to operate Essential Businesses/Operations. • Non-essential businesses/operations must cease or exclusively consist of employees working from home. • Essential businesses & operations defined in the order, must comply with Social Distancing Requirements, including separate operating hours for vulnerable and elderly populations • All gatherings of any number of people outside a household are prohibited Less restrictive local ordinances preempted	Stay at home order lifted (expired April 26, 2020)		5-Apr	https://covid19.mt.gov/Portals/223/Documents/Stay%20at%20Home%20Directive.pdf?ver=2020-03-26-173332-177
Nebraska	Statewide mandate: Restaurants and bars limited to 10 patrons at a time **3/19/2020:** Cass, Douglas, Sarpy and Washington counties, until 4/30/20: • Gatherings above 10 people prohibited, including schools, daycare facilities, gyms, salons, auditoriums, stadiums, theaters. Excluded: airports, bus/train stations, malls and centers, “typical office environments,” factories, retail or grocery stores • restaurants closed except takeout, carry-out or delivery • Schools must operate without students **3/29/2020**: Burt, Cuming, Madison, Stanton, Dodge, Lancaster, Saudners, Washington, Butler, Hall, Hamilton,	Expanded list of counties	2-Apr	5-Apr	Nebraska Dept. of Health and Human Services, Directed Health Measure Order 2020-001: https://www.dropbox.com/s/sk95elfp6bnefsv/DHM%203.19.2020.pdf?dl=0 https://governor.nebraska.gov/press/gov-ricketts-announces-15-counties-north-and-central-nebraska-now-included-state%E2%80%99s-directed

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	Merrick, Polk, Seward, and York counties added to directed health order **4/02/2020:** expanded to 56 counties				
Nevada	Statewide closures: Non-essential business closed to public, including restaurants, gyms, bars, hair/nail salons, etc. All gaming machines/equipment shut down **3/24/2020** – Declaration of Emergency Directive 007: Ban on gatherings of 10+ people in public/private, except essential businesses or people living in the same household. **4/01/2020** -- Full stay at home order	Full stay at home order extended to May 15, 2020	2-Apr	5-Apr	https://www.clarkcountynv.gov/covid19/Pages/default.aspx; https://nvhealthresponse.nv.gov/wp-content/uploads/2020/03/3.20-Press-Release.pdf; https://nvhealthresponse.nv.gov/wp-content/uploads/2020/03/Declaration-of-Emergency-Directive-007.3-24-20-1.pdf https://nvhealthresponse.nv.gov/wp-content/uploads/2020/04/Declaration-of-Emergency-Directive-010-Stay-at-Home-3-31-20.pdf
New Hampshire	**3/26/2020**: Stay-at-home order: • All businesses other than "Essential Services" must close physical workplaces and facilities, but encouraged to continue remote operations • Essential Services identified in separate Exhibit A, subject to change: https://www.governor.nh.gov/news-media/emergency-orders/documents/emergency-order-17.pdf • All New Hampshire citizens to stay at home Exempted for K-12 schools, religious institutions, and State and local government	Stay at home order extended to May 31, 2020		5-Apr	https://www.governor.nh.gov/news-media/emergency-orders/documents/emergency-order-17-1.pdf

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New Jersey	**3/21/2020**: State-wide shelter in place; closure of all non-essential retail businesses to the public, see order for list of exceptions. - Nothing in the Order shall limit 1) the provision of health care or medical services; 2) access to essential services for low-income residents, such as food banks; 3) the operations of the media; 4) law enforcement agencies, or 5) the operations of the federal government. - Additionally, the order mandates that all businesses or non-profits, wherever practicable, must accommodate their workforce for telework or work-from-home arrangements. To the extent a business or non-profit has employees that cannot perform their functions via telework or work-from-home arrangements, the business or non-profit should make best efforts to reduce staff on site to the minimal number necessary to ensure that essential operations can continue. **3/30/2020** - updated guidance for real estate/car dealerships/other industries available at http://d31hzlhk6di2h5.cloudfront.net/20200330/49/ef/6b/66/911f57575b4616fb2dd79d8a/AO2020-6_signed.pdf	Updated guidance on essential businesses	31-Mar	5-Apr	https://nj.gov/governor/news/news/562020/approved/20200320j.shtml
New Mexico	**3/24/2020** - Stay-at-home order: All non-essential business must close or transition to 100% remote workforce; Essential businesses must adhere to social distancing protocol; Casinos/racetracks are closed; Hotels/lodging must operate at 50% or less of capacity; Grocery stores and other retailers are hereby directed to limit the sale of medications, durable medical equipment, baby formula, diapers, sanitary care products, and hygiene products to three items per individual; Essential businesses are listed in the order	Stay at home order extended to May 15, 2020		5-Apr	https://www.governor.state.nm.us/wp-content/uploads/2020/03/COVID-19-DOH-Order-fv.pdf

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New York	**3/21/2020**: Statewide stay at home: The Governor's 10-point "New York State on PAUSE" Executive Order requires: 1. Effective at 8PM on Sunday, March 22, all non-essential businesses (updated guidance re essential businesses available here) statewide will be closed; 2. Non-essential gatherings of individuals of any size for any reason (e.g. parties, celebrations or other social events) are canceled or postponed at this time; 3. Any concentration of individuals outside their home must be limited to workers providing essential services and social distancing should be practiced; 4. When in public individuals must practice social distancing of at least six feet from others; 5. Businesses and entities that provide other essential services must implement rules that help facilitate social distancing of at least six feet; 6. Individuals should limit outdoor recreational activities to non-contact and avoid activities where they come in close contact with other people; 7. Individuals should limit use of public transportation to when absolutely necessary and should limit potential exposure by spacing out at least six feet from other riders; 8. Sick individuals should not leave their home unless to receive medical care and only after a telehealth visit to determine if leaving the home is in the best interest of their health; 9. Young people should also practice social distancing and avoid contact with vulnerable populations; and 10. Use precautionary sanitizer practices such as using isopropyl alcohol wipes. "Matilda's Law" includes the following rules for vulnerable populations (including individuals age 70 and older, those with compromised immune systems and those with underlying illnesses): Remain indoors; Can go outside for solitary exercise; Do not visit households with multiple people; Wear a mask when in the company of others; To the greatest extent possible, everyone in the presence of vulnerable people should wear a mask; Always stay at least six feet away from individuals; and Do not take public transportation unless urgent and absolutely necessary **3/21/2020** Executive Order 202.9 - directing Superintendent for Department of Financial Services to: Make it easier for consumers to			5-Apr	https://www.governor.ny.gov/executiveorders

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	receive a forbearance for payments of their mortgage; Restrict bank charges for ATM fees, overdraft fees, and credit card late fees **3/23/2020** Executive Order 202.10 - Banning "non-essential gatherings of individuals of any size for any reason"; Relaxes rules for medical professionals to make it easier to respond to pandemic **3/27/2020** Executive Order 202.11 - Provides automatic 30-day extensions for (1) business who require licenses to operate to extend the expiration date of their licenses; (2) continuing education/training requirements to be met; (3) safety inspections, etc.; Closes all public schools through April 15, 2020, subject to further extensions; Adds additional enforcement measures for (1) businesses that continue to operate in violation of previous Orders or (2) operates a business beyond the occupancy requirements set forth in prior Orders. Police are now authorized to "remove persons from such space or facility," issue an appearance ticket, issue a "Do Not Occupy Order," or pursue other expressed remedies.				
North Carolina	Executive Order 120 has been signed and issued: Schools closed until May 15 **3/28/2020** Executive Order 121 - effective March 30: Stay at home unless "Essential Activities" or Essential Business (includes CISA categories and others)	Stay at home order extended to May 8, 2020		5-Apr	https://files.nc.gov/governor/documents/files/EO121-Stay-at-Home-Order-3.pdf
North Dakota	Statewide closure: All K-12 schools closed; Restaurants/dining establishments limited to take-out/delivery/drive through; Recreational facilities, gyms, theaters, etc. closed through 4/6/2020; State agencies/offices accelerate transition of non-essential staff to remote home work			5-Apr	Executive order 2020-04.1: https://www.governor.nd.gov/sites/www/files/documents/executive-orders/Executive%20Order%202020-04.1%20COVID-19.pdf Executive order 2020-06: https://www.governor.nd.gov/sites/www/files/documents/executive-orders/Executive%20Order%202020-06.pdf

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Ohio	3/23/2020 - Stay at home order issued. Individuals can leave for essential activities, essential government functions, or essential businesses and operations. All non-essential businesses to close unless they are operated from individuals' own homes. All gatherings above 10 people prohibited unless exempt. Essential businesses to remain open: CISA List, grocery stores and pharmacies, food beverage and marijuana production and agriculture, charitable and social service organizations, religious entities, media, gas stations, financial and insurance institutions, hardware, critical trades, mail/delivery, schools, laundry services, restaurants (delivery/drive-through/take-out), supplies for essential business/operations, transportation, professional services, manufacturing, labor unions, hotels and motels, and funeral services. **4/03/2020 -** updated order with stricter requirements	updated definitions and requirements for operations Stay at home order extended to May 29, 2020	5-Apr	5-Apr	https://coronavirus.ohio.gov/static/publicorders/Directors-Stay-At-Home-Order-Amended-04-02-20.pdf
Oklahoma	3/24/2020 – Fourth Amended Executive Order 2020-07 - closes all non-essential businesses (per CISA) from March 15 - April 15.; State-wide "Safer at Home" order for adults over 65 and medically vulnerable people; Limits gatherings to 10 people 3/25/20 - Additional clarification re essential businesses found here: https://www.maine.gov/governor/mills/sites/maine.gov.governor.mills/files/inline-files/FAQS%20-%20Business%20Closures%20Executive%20Order%20Number%2019%20V2_0.pdf **4/1/2020**: Further restrictions on businesses/gatherings	Increased restrictions on activities Stay at home order lifted May 1, 2020	2-Apr	5-Apr	https://www.sos.ok.gov/documents/executive/1919.pdf https://www.sos.ok.gov/documents/executive/1926.pdf

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Oregon	Executive Order 20-12: - Requires residents to stay home, except to run or hike; Bans non-essential gatherings of any size; Closes enumerated businesses: includes amusement parks, hair salons, bowling alleys, furniture stores, boutiques, gyms, "indoor and outdoor malls," spas, museums, senior centers, ski resorts, social and private clubs, tattoo parlors and theaters - Authorizes the Oregon Health Authority to come up with other nonessential businesses that will need to close. It leaves restaurants, bars and cafes open, as long as they serve only takeout food. - Open businesses required to designate an employee or officer to “establish, implement and enforce” social distancing policies consistent with Oregon Health Authority guidance **3/27/2020** - updated guidance on order https://www.oregon.gov/gov/admin/Pages/eo_20-12-homelessness-guidance.aspx			5-Apr	https://www.oregon.gov/gov/Documents/executive_orders/eo_20-12.pdf
Pennsylvania	**3/20/2020**: Statewide shutdown of non-life-sustaining businesses: No person or entity shall operate a place of business that is not a life sustaining business (excluding virtual or telework operations (e.g., work from home)); Life sustaining businesses may remain open, but they must follow, at a minimum, the social distancing practices and other mitigation measures defined by the Centers for Disease Control to protect workers and patrons; A (long) list of life sustaining businesses is available; Restaurants and bars must close dine-in facilities, but carry-out, delivery, and drive-through food and beverage service may continue, so long as social distancing and other mitigation measures are employed; Enforcement actions will be taken against businesses that are out of compliance effective March 19, 2020, at 8 p.m. **3/23/2020**: Governor Wolf, noting that Philadelphia has already ordered residents to remain home, issued his own stay-at-home order for nearby counties. That order took effect at 8:00 p.m. on 3/23 and requires all citizens within these counties to stay home with few exceptions/caveats: • Access life sustaining businesses • For employees of lift sustaining businesses, to access childcare services	Now state wide.	1-Apr	5-Apr	https://www.governor.pa.gov/wp-content/uploads/2020/03/20200319-TWW-COVID-19-business-closure-order.pdf; https://www.governor.pa.gov/wp-content/uploads/2020/03/03.23.20-TWW-COVID-19-Stay-at-Home-Order.pdf

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
	• Whenever out of the home, citizens must practice social distancing As of 4/1 all counties are included				
Rhode Island	**3/24/20**: Any person returning to the state via domestic air travel must self-quarantine for 14 days. **3/26/20:** Department of Business Regulation Guidelines: Businesses that are still open must limit crowds to 20% of capacity generally and 10% capacity during special hours for at-risk populations. Must clearly mark six feet spacing in high traffic areas. Must designate employees to monitor social distancing. To take effect 3/26 at 5:00 PM. **3/28/2020**: Executive Order: Gatherings of 5 or more prohibited; Stay at home except for necessary activities (work included); Non-essential retail closed	Stay at home order, but includes all work in essential activities	28-Mar	5-Apr	https://health.ri.gov/publications/exec-orders/ExecOrder20-03.pdf https://health.ri.gov/publications/exec-orders/ExecOrder20-04.pdf http://www.governor.ri.gov/documents/orders/Executive-Order-20-13.pdf

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South Carolina	No shelter in place. All non-essential employees and staff of the state must not report to work. Essential employees are determined by the relevant agency head. Closure of all public schools for students and non-essential employees. Urging that public gatherings be canceled or limited to fewer than 100 people. On-site consumption of food at restaurants prohibited. Events at government facilities may not exceed 50 people. Law enforcement ordered to disperse groups of three or more. Does not apply to law-abiding businesses or families on outings Localized shelter in place orders. **3/25/2020** Governor's Statement: Requesting out of state visitors self-quarantine for a period of two weeks upon arrival. **3/31/2020**: Closure of all nonessential businesses (listed closures, not exemptions) **04/03/2020**: added to list of nonessential businesses	Added to list of nonessential businesses Stay at home order extended to May 12, 2020	4-Apr	5-Apr	Executive Order https://www.charleston-sc.gov/2408/City-of-Charleston-Coronavirus-Updates https://governor.sc.gov/sites/default/files/Documents/Executive-Orders/2020-03-31%20eFILED%20Executive%20Order%20No.%202020-17%20-%20Closure%20of%20Non-Essential%20Businesses.pdf https://governor.sc.gov/sites/default/files/Documents/Executive-Orders/2020-04-03%20eFILED%20Executive%20Order%20No.%202020-18%20-%20Closure%20of%20Additional%20Non-Essential%20Businesses.pdf
South Dakota	No shelter in place. Encouraging adherence to CDC guidelines. Telework for state employees until March 30. Schools closed. **3/23/2020:** Executive order encouraging businesses that serve the public to limit gatherings in enclosed spaces to 10 persons or fewer. Encouraging food service providers to emphasize take-out and delivery.			5-Apr	https://doh.sd.gov/news/Coronavirus.aspx https://news.sd.gov/newsitem.aspx?id=26560 http://www.cityofbrookings.org/civicalerts.aspx?AID=2851
Tennessee	Restaurants, bars, gyms closed statewide. Encouraging adherence to CDC guidelines. **3/30/2020**: Statewide stay at home and all non-essential businesses closed **04/02/2020**: strengthened stay at home language	Stay at home order lifted (expired April 30, 2020)		5-Apr	https://www.tn.gov/governor/news/2020/3/22/gov--bill-lee-signs-executive-order-mandating-alternative-business-models-for-restaurants-and-gyms--lifts-alcohol-regulations.html; https://www.tennessean.com/story/news/local/2020/03/24/coronavirus-tennessee-tuesday-updates-cities-urge-residents-stay-home/2905451001/ https://publications.tnsosfiles.com/pub/execorders/exec-orders-lee23.pdf

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Texas	No shelter in place. People shall avoid gathering in groups of more than 10. People shall avoid entering restaurants and bars, however delivery and drive-thru are encouraged. Schools closed. **3/31/2020**: All non-essential services must be provided remotely, or not at all. Preempts local orders to the extent they prohibit essential services listed in state order. Restrictions on social distancing etc. still effective	Stay at home order lifted (expired April 30, 2020)		5-Apr	https://gov.texas.gov/news/post/governor-abbott-issues-executive-orders-to-mitigate-spread-of-covid-19-in-texas; https://www.nbcdfw.com/news/coronavirus/texas-ohio-orders-on-surgeries-prompt-new-abortion-fight/2336940/ http://www.austintexas.gov/edims/document.cfm?id=337770 http://www.austintexas.gov/sites/default/files/files/Travis%20County%203-20-2020%20-%20County%20Order%20Gathering%20of%2010%20or%20greater%20-%20No%202020-04.pdf
Utah	No shelter in place. **3/18/2020**: all bars and restaurants must suspend dine-in services for two weeks; schools will be closed and classes will be held remotely; Non-essential gatherings of 10 or more prohibited; Recommends that immunocompromised individuals and those over 60 not participate in gatherings of more than 20 people. **03/27/2020**: effective 3/30 "directive" to promote remote work and compliance with CDC guidelines, limit travel	"Directive" to work remotely, limit travel, and otherwise comply with CDC guidelines. Unclear if force of law or not	29-Mar	5-Apr	https://governor.utah.gov/2020/03/18/state-orders-restaurants-bars-to-suspend-dine-in-services-to-slow-spread-of-covid-19/ https://governor.vermont.gov/sites/scott/files/documents/ADDENDUM%204%20TO%20EXECUTIVE%20ORDER%2001-20.pdf
Vermont	**3/24/2020**: Stay at home order issued; all non-essential businesses shut down. Information re definition of essential businesses included in order			5-Apr	https://governor.vermont.gov/sites/scott/files/documents/ADDENDUM%206%20TO%20EXECUTIVE%20ORDER%2001-20.pdf
Virginia	**3/23/2020** Schools closed for remainder of year. All recreation and entertainment businesses must close. Essential businesses will remain open. **3/30/2020** : Shelter in place order, all non-essential businesses closed	(Shelter in place order issued, but exempts travel for work (long list of closed businesses)	30-Mar	5-Apr	https://www.governor.virginia.gov/media/governorvirginiagov/executive-actions/EO-55-Temporary-Stay-at-Home-Order-Due-to-Novel-Coronavirus-(COVID-19).pdf
Washington	**3/24/2020:** shelter in place order. Details regarding essential businesses included in order and available here: https://www.governor.wa.gov/sites/default/files/WA%20Essential%20Critical%20Infrastructure%20Workers%20%28Final%29.pdf **3/28/2020:** updated guidance https://www.governor.wa.gov/news-media/inslee-issues-additional-guidance-funerals-and-real-estate-transactions-letter-tribal	Stay at home order extended through end of May		5-Apr	https://www.governor.wa.gov/sites/default/files/proclamations/20-25%20Coronovirus%20Stay%20Safe-Stay%20Healthy%20%28tmp%29%20%28002%29.pdf (order); https://www.governor.wa.gov/sites/default/files/WA%20Essential%20Critical%20Infrastructure%20Workers%20%28Final%29.pdf (essential businesses)
West Virginia	**3/23/20** Governor's Order: Stay at home order issued, effectively 8 p.m. Tuesday (3/24). Essential businesses and operations cite to CISA.			5-Apr	https://coronavirus-wvgovstatus-cdn.azureedge.net/STAY_AT_HOME_ORDER.pdf

State	Level of Restriction	Brief Summary of most recent change	Last Updated	Current	Source
Wisconsin	**3/24/20**: Governor's safer at home order goes into effect, including details re essential businesses			5-Apr	https://evers.wi.gov/Documents/COVID19/EMO12-SaferAtHome.pdf
Wyoming	**3/19/20** Governor's Order: Statewide closure of businesses such as bars, gyms, and restaurants. **3/20/2020:** Gatherings of more than 10 prohibited. **3/25/2020**: State Health Officer Order: statewide closure of non-essential personal service providers (salons, barbershops, tattoo parlors) Localized stay at home orders, including one on Indian land (https://www.wyomingpublicmedia.org/post/covid-19-reaches-wind-river-tribes-issue-stay-home-directive#stream/0)			5-Apr	https://health.wyo.gov/publichealth/infectious-disease-epidemiology-unit/disease/novel-coronavirus/covid-19-orders-and-guidance/

OTHER NOTABLE GLOBAL ORDERS

1. Britain – placed under nationwide lockdown (https://www.theguardian.com/world/2020/mar/23/uk-lockdown-what-are-new-coronavirus-restrictions)
2. India – placed under nationwide lockdown (https://www.axios.com/india-coronavirus-lockdown-fd753cb9-efbd-45b0-9008-16d51272c961.html)
3. Germany – a number of states imposed partial lockdown or quarantine measures (https://www.dw.com/en/germany-reports-few-violations-as-states-impose-coronavirus-lockdowns/a-52871927)

XVI. ANNEX B: HOTEL CLOSING CHECKLIST

A. Emergency Response Team

1. Follow advice and actions as outlined by local health and government officials.
2. Refer to the following protocols:

    a. Employee becomes ill at work and or believes they have been exposed to COVID-19.
    b. Employee tests positive for COVID-19.
    c. Guest becomes ill and or believes they have been exposed to COVID-19.
    d. Discuss property closure with VPO and Ownership. Determine the closure date.
    e. Schedule daily update briefing during the evacuation and closure.
    f. Account for all personnel and guest after property evacuation is complete.
    g. Dismiss all non-essential personnel after property evacuation is complete.
    h. Manage all aspects of property shutdown. Lock the property front doors.
    i. Schedule daily Security briefings past closure.
    j. Determine the engagement of outside cleaners.

B. Guest Services

1. Primary: Front Office Manager & Front Office Supervisor

    a. Staff the front desk with ample personnel to effect an orderly check out of guests.
    b. Implement notification procedures for employees and guests on public area bulletins including elevators. To ensure an orderly evacuation, contact guests and inform them of their checkout times. Make sure to collect room keys or change key codes so that guest cannot return to their rooms.
    c. Secure all in-house banks.
    d. Inventory safety deposit boxes.

2. Determine if any guests require transportation. If there are:

    a. Arrange for enough vehicles to evacuate guests.
    b. If necessary, secure all excess baggage in predetermined locations and give guests a receipt for their baggage left behind, and take luggage to an upper floor.
    c. At the time of checkout, provide guests with directions, maps, and transportation.
    d. Telephone auto-attendant recording changed to advise guests of operation's closure and giving telephone number to contact at a central location.
    e. Secure all equipment such as bell carts and lock all Guest Services area
    f. Work with the waste hauler and recycling company to reduce the number of pick-ups based on occupancy and usage.
    g. Work with elevator company to eliminate after-hour callbacks except for entrapments. All repairs should be done during normal business hours.

C. Opera Suspension Preparation Steps

1. Ensure all guests are checked-out.
2. Print and email Downtime Reports.
3. Adjust inventory of all groups for the affected dates.
4. Extend all PM (or PQ) accounts due to depart during the period of suspended operations.
5. Run the Opera End of Day (Night Audit) process daily.
6. Review Opera OXI on a daily basis and resolve any errors/warnings.

D. Sales & Reservations

1. Primary: Director of Sales & Marketing & Director of Revenue Management

   a. Implement communication procedures to communicate to all future guests that have reservations arriving during the closure.
   b. Follow Emergency PR protocol for communication with media (if needed).
   c. Communicate with HO to set up appropriate messaging on the website and phone voicemails.
   d. Communicate with HO to setup appropriate messaging on the Electronic platforms.
   e. Address On hold message on the main hotel number.
   f. Create closure notices for the property.
   g. Create a script for staff answering phones and security personnel manning the building.
   h. Contact IT to set up Reservations and call forwarding for the sales line.
   i. Contact IT to power down all devices and to set up remote access.
   j. Clean the office area and remove all trash.
   k. Turn off lighting, adjust HVAC and secure the office.

2. Group Reservations.
3. Identify contracted accounts to notify (crew, volume, groups, direct channel, social, etc.).
4. Generate prepared statement using suspension of services language targeted to each market segment.

   a. Notify HSF and seek guidance in communication.
   b. Provide options for temporary accommodations. Local laws may make relocation impossible, focus on rebooking for future dates.
   c. Move events to alternative dates in the future after suspension.
   d. Check for groups & events with deposit payments that have already been made – determine how the payment will be returned as appropriate or applied to.
   e. Stay in close contact and enhance partnership with key OTAs, Corp accounts and DMC.
   f. Arrange forwarding calls to GCC or a colleague that will be answering phones at another location.
   g. Prepare a list of all such colleagues requiring the remote access and what applications they need to access (Envision, Prio, Reserve, Opera, etc.).
   h. Proactively come up with new strategies on how to overcome and compensate for the loss in revenue (not only for March, but for the next two to three months).

      (i) Set up a system of ongoing communication with Event and Sales Managers.
      (ii) Turn off Automated Reports for all Closure dates.
      (iii) Provide all colleagues on e-mail with appropriate out of office messages.
      (iv) Designate someone to handle credit applications in progress.
      (v) Establish billing questions/adjustments procedure.
      (vi) Establish procedure for any contracts that may come in during the period of closure.
      (vii) Write a lead process SOP for colleagues working remotely.
      (viii) Establish procedure for how new bookings be approved/ rate set?
      (ix) Post a message on CVent about the suspension of operations.
      (x) Determine how quotas will be managed or set during this period.
      (xi) Determine if the hotel needs to notify STR.
      (xii) If a skeleton crew is working, have IT create a group e-mail address that can be given to all clients.
      (xiii) Ask clients during the suspension to send all communication to that e-mail address, so whoever is on duty can handle.
      (xiv) Create one document to communicate all cancellations.

(xv) Make sure you have a current cell phone number for each colleague.
(xvi) Maintain of a list of area hotels that have remained open.
(xvii) Update voicemail and/or forward phones.

E. Human Resources

1. Primary: Human Resources Director & Human Resources Coordinator

   a. Contact HO HR and set up communication protocol.
   b. Verify there is contact info for all employees.
   c. Communicate the script developed with HO HR to all employees via shift line ups, email and other media.
   d. Clean the office and remove all trash.
   e. Ensure all staff is accounted for after the closure.
   f. Set up VM message on the HR phone utilizing the script developed with HO HR.
   g. Create a communication group to continuously update the staff during the closure and date of return (when that is established).

F. Housekeeping

1. Primary: Dir of House Keeping & Dir of Rooms

   a. Physically check each room to make sure everyone has evacuated, and no personal belongings have been left behind.
   b. Shut down all vacant rooms.
   c. Remove soiled linens/terry and process so left in clean condition.
   d. Remove guestroom trash, debris and all room service trays.
   e. Clean - or at a minimum - strip/detrash all rooms. Do not replace linen/terry. Linen/terry to be replaced when room is back in service.
   f. Switch off lights in guestrooms / adjust room temperature to maximum efficiency. Close drapes and shades after rooms are cleaned.
   g. Clear BOH areas and public restrooms of garbage.
   h. Process all soiled uniforms.
   i. If uniforms are rented, return all uniforms for furloughed team members.
   j. Update cleanliness status of all rooms.
   k. Review contract service and arrange change or cancel routine.
   l. Review plant and landscape protocols.
   m. Conduct inventory of guest supplies to assess how much supply will be on hand upon reopening.
   n. Consider covering clean linen/terry in storage closets and room attendant carts to avoid dust build up.
   o. Forward phones.
   p. Work with Engineering to shut down and isolate all non-essential equipment.
   q. Contact main goods suppliers to advise of suspended operations and defer existing orders.
   r. Update voicemail and/or forward phones.

G. Laundry

1. Process all soiled terry, linens, uniforms, and F&B.
2. Consider covering clean linen/terry in bins and laundry carts to avoid dust build up.
3. Work with Engineering to shut down and isolate all non-essential equipment.
4. If uniforms are rented return all uniforms for furloughed team members.
5. Contact main goods suppliers to advise of suspended operations and defer existing orders.

H. Food & Beverage

I. Primary: Director of Food & Beverage & Executive Chef

1. General

a. Return cash bank to Finance
b. Cash-in all due backs / tip-outs
c. Clear schedules in Kronos or payroll system.
d. Complete Inventory of all items in coordination with Finance.
e. Complete month end financial closing procedures.
f. Run a GL report to ensure all expenses are properly coded.
g. Contact service providers modify scope of work re-negotiate agreements.
h. Ensure outstanding POs are in the system and approved for payment as required.
i. Understand what deliveries are scheduled and make arrangements as required.
j. Submit any work orders to engineering prior to closing down.
k. Update Restaurant Reservation System.

(i) Close bookings for new reservations.
(ii) Ensure hotel / restaurant contact details are correct and up-to-date for enquires.
(iii) Print off all future reservations and guest contact details for remainder of the year.
(iv) Contact existing reservations about the decision to suspend operations.
(v) Start with large parties and those with special events.
(vi) Offer alternatives including relocation to sister properties for large events.
(vii) Full refund with no penalty to be offered.

J. Goods

1. Cross check alcohol Pars and log variances.
2. Maintain a zero inventory of perishable goods – Freeze or Dispose as required.
3. Maintain an accurate record of items in these categories: Spoilage, Donated, or Discarded.
4. Ensure all items that remain are stored correctly.
5. Empty all guest room Mini Bars.
6. Reconsolidate supplies to general store room.
7. Record expiry dates and set aside items with shelf lives of 60 days or less.
8. Contact main goods suppliers to advise of suspended operations and defer existing orders.

K. Equipment

1. Ensure all essential refrigerators and freezers are connected to emergency backup power.
2. Power off and unplug all appliances.
3. Ensure that all items have been deep cleaned prior to switching off.
4. Turn off all mini bar fridges in guest rooms and leave doors open.
5. Switch off and clean all ice machines.
6. Walk-in coolers to be consolidated and unused areas to be turned off.
7. Transfer food items to one main storage area.
8. Keep all doors open for ventilation.
9. Switch off all refrigerators and freezers not in use; keep the doors open for proper ventilation;
10. Inventory all OS&E and return to designated stewarding area.
11. Inventory and store all movable equipment. Remove and store all market displays.

L. Outlet Spaces

1. Ensure proper physical communication is posted for external guests.
2. Return keys.
3. If any key rings are missing, locks associated with the key rings must be re-keyed prior to leaving the building.
4. Implement key lockout procedures for storage areas.
5. Turn off Music System.
6. Turn off Lighting.
7. Update voicemail and/or forward phones.

M. Stewarding

1. Deep clean all kitchen and F&B back of house areas.
2. Inventory and store chemicals and flammables correctly.
3. Clean, inventory and properly store all kitchen utensils.
4. Clean, inventory and properly store all OS&E - china, glassware, silverware.
    a. If storage space is not available utilize events room that can be secured and allow for BOH areas to be deep cleaned as required.
5. Drain dishwashers and close down as directed.
6. Deep clean trash room once final pick-up is completed.
7. Coordinate removal of soiled oils from kitchens and dispose of accordingly.
8. Ensure correct procedure to maintain drains during closure; coordinate with Engineering.
9. Review pest control to ensure necessary precautions are in place.
10. Contact main goods suppliers to advise of suspended operations and defer existing orders
11. Physically apply labels to each piece of equipment – outlet name and area.

N. Recreation

1. Primary: Recreation Manager

    a. Secure any outside equipment or bring it inside for storage.
    b. Clean the area and remove all trash.
    c. Contact IT to power down any devices and applications.
    d. Turn off all lighting, adjust HVAC temp and secure the area.

O. Administration

1. Primary: Director of Finance

    a. Clean the office area and remove all trash.
    b. Account for and remove any pertinent files.
    c. Contact IT to power down any devices and to ensure remote access is set up for working remotely.
    d. Turn off all lighting, adjust HVAC temp and secure the area.

P. Information Technology

1. Primary: Director Of IT

    a. Contact HO IT for guidance on shutting down systems.
    b. Shutdown all devices and applications by department as directed by HO IT.
    c. Power down any non-essential switches and systems as directed by HO IT.

d. Activate Remote Access for staff to work remotely.
e. Set up Reservations call forwarding.
f. Set up Main Switch and Sales call forwarding as directed by GM.
g. Report back to HO IT once all the tasks are complete to ensure forwarding services are operational.

Q. Maintenance

1. Primary: Dir. Of Facilities & Engineering

a. General

(i) 24/7 engineering coverage, or an appropriate plan for 24/7 coverage provided by others, must be in place.

(a) Pre-shift and post-shift meetings must be held between all shifts to ensure relevant information is passed on.

(ii) Establish a communication protocol for reduced staffing levels (HotSOS, radios, text, cell phone, etc.).
(iii) Engineering is to complete building rounds checks to inspect the property and ensure proper operation of essential equipment a minimum of 3 times per.

(a) Create a formal checklist detailing all areas and systems to be checked.
(b) Add items which would normally be handled by others but will not be in the short term, such as recording refrigeration temperatures.

(iv) Any compliance required maintenance and/or inspections, such as hood cleaning, must be completed on the required schedule.
(v) All chemicals are to be properly closed, stored, and secured.
(vi) Prepare all motorized equipment/golf carts for an extended period of down time.

(a) All battery powered equipment should be left on chargers.

(vii) Inform all applicable suppliers of changed delivery schedules or pick-up needs, such as waste and recycling haulers, compost haulers, propane delivery, etc.
(viii) Document the shutdown/startup sequence of closed spaces and equipment to ensure proper startup when the spaces are returned to normal operation.
(ix) Any annual testing services, such as fire alarm testing, should be scheduled during the suspension of operations, if possible.

b. Life Safety

(i) Egress routes from all areas must remain clear at all times.
(ii) Fire and life safety systems must remain in operation in all areas at all times fire alarm panel.

(a) If work is to be performed on these systems then the impairment program must be followed.

(iii) Ensure the emergency generator and UPS systems are fully operational and in automatic mode; fuel tanks should be full.

c. HVAC

(i) Air conditioning and ventilation can be reduced where appropriate, but must not be turned off entirely.

(a) Maintain required outside air supply to all areas.
(b) Temperature set points are to be adjusted to reduce heating and cooling as appropriate.
(c) Work with your guest room energy management system provider to put deep setbacks in place for all unoccupied guestrooms.
(d) Work with your building automation system service provider to adjust programming as necessary.
(e) Schedule meeting room and ballroom ventilation off.

d. Elevators & Escalators

(i) Shut down elevators where possible; keep 2 operational at minimum in any elevator bank.
(ii) Shut down all escalators.

e. Energy Savings

(i) Ensure all lights are turned off using wall switches or central control systems only; emergency lighting must remain in service.
(ii) Isolate energy sources (gas, water, electric, etc.) for all non-essential equipment to completely shut down the equipment; find a few examples below:

(a) Power down all computers and monitors which will not be used.
(b) Close main gas supply to every kitchen which is being closed.
(c) Power off and empty all ice machines which will not be used.
(d) Consolidate content in all refrigerators and freezers to as few walk-in fridges and freezers as possible, powering off any fridges and freezers which will not be used.
(e) Empty and unplug guestroom minibars.
(f) Power off music systems.

(iii) Close loading dock overhead doors; keep them closed as much as possible
(iv) Review and implement the procedures in the spa suspension of operations document.

f. Landscaping and Acreage

(i) Reduce maintenance services to the minimum required.
(ii) Defer any non-critical plant, sod, mulch, etc. purchases.
(iii) Irrigation should be maintained as per normal.

R. Ensuring Water Safety During Partial or Full Building Closure

1. The cooling water treatment program inclusive of all required monitoring and testing must be maintained during a building closure.
2. Depending on the length of the partial or full building closure it may be necessary to flow water at multiple locations throughout the building to prevent the water from stagnating and to prevent the need for a required disinfection of the system later.

3. It is recommended to create a local round in Transcendent for flowing water in areas of the hotel that have been closed and unoccupied for more than 7 days.
4. Flowing both hot and cold water for 5 minutes minimum, every 7 days, will prevent the water from becoming stagnant and prevent odors from emanating from In guest rooms, water should be flowed through all fixtures including the bath sink, bar or kitchen sink, tub spout showerhead and handheld shower.
5. The toilet should be flushed twice and lightly scrubbed if needed.
6. Public restrooms, back of house sinks, kitchens, and laundries should also be included in this round if closed for more than 7 days. During this round it is recommended to also pour fresh water down floor drains.

S. Examples of the critical equipment that should NOT be shut down during a partial or full building closure include, but are not limited to, the following:

1. Fire Alarm System
2. Emergency Lighting
3. Fire Pump
4. Sprinkler System Controls
5. Computer Room AC
6. Domestic Water Pumps
7. Sewage Ejection Pumps
8. Sump Pumps or Lift Stations (Dewatering Pumps)
9. Radio Repeaters
10. Cell Phone Towers or Repeaters
11. Security Systems, Cameras, and Monitors
12. PBX Switch
13. Building Automation System

T. Security

1. Primary: Director Of Security & Director of Operations

   a. Divide the property into zones and assign each zone to Manager or Security personnel.

2. Ask the above-mentioned to inspect the following:

   a. All outside equipment is secure or brought in
   b. All equipment is turned off
   c. All windows and egress are secure
   d. All lights are turned off
   e. HVAC is adjusted to right temp
   f. All entry doors are secure
   g. Advise Dir of Security/ DOO of any concerns
   h. Place closure signs on all outside doors and entry areas.
   i. DOO and Dir of Security to walk the property perimeter for a final check.
   j. Lock the property front doors and post the closure signs.
   k. Inventory key control systems to ensure all keys have been returned.

3. During Closure, plan for following protocol:

   a. Schedule Security & Maintenance staff to patrol the property and man key entry and exit points of the building
   b. Ensure Team Leader/ Supervisor has keys to access the property in case of an emergency.

c. Create and share script with Security team in case any questions are asked.
d. Create a log to record any visitors.
e. Conduct a daily shift meeting (remotely if needed) and pass along the report to ERT.
f. Reduce access points to the building where possible.
g. Egress routes from all areas must remain clear at all times; non-emergency doors should be secured to prevent unnecessary access to closed areas.

Credit to HotelAVE for providing this closing checklist.

XVII. ANNEX C: COVID-19 SCREENING CHECKLIST FOR EMPLOYERS

Name: ____ **Date:** ______________ **Time:** ______________

Purpose: Based on the Febrile Respiratory Illness Health Order that took effect on 03/26/2020, all employers, on a daily basis, are to screen all employees for signs of respiratory illness accompanied by fever.

Instructions: ALL employees and government officials entering the building must be asked the following below. Please maintain this record for 14 days from completion of this form and have this form available upon request from the Public Health Department.

1) **Have you washed your hands or used alcohol-based hand sanitizer on entry?**
☐YES ☐NO – Ask them to do so.

2) **Do you have any of the following respiratory symptoms?**
☐Fever ☐New or worsening cough ☐New or worsening shortness of breath
- If YES to any, restrict them from entering the building and send the person home.*
- If NO to all, proceed to remaining questions

3) **Employee's temperature: __________°F. If you do not have a thermometer to take their temperature, go to step #3B.**

3A) **Does the employee have a fever (temperature 100.4°F or greater)** ☐YES ☐NO
- If YES to any, restrict them from entering the building and send the person home.*
- If NO, proceed to question #3C.

3B) **Ask the employee the following:**
1. Are you feeling feverish? ☐YES ☐NO
2. Are you having chills? ☐YES ☐NO
- If YES to any, restrict them from entering the building and send the person home.*
- If NO, proceed to question 3C.

3C) **Ask the employee the following:**
1. Have you worked in facilities with confirmed COVID-19 cases? ☐YES ☐NO
- If YES, ask question #2 below.
- If NO, proceed to step #4.

2. Have you worked with persons with confirmed COVID-19 by lab test? ☐YES ☐NO
- If YES to any, restrict them from entering the building and send the person home.*
- If NO, proceed to step #4.

4) **Allow entry to building and remind individual:**
☐ Wash hands or use alcohol-based hand sanitizer throughout time in building.
☐ Refrain from shaking hands with, touching, or hugging others during time in building.

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*** The person being sent home must inform their supervisor and/or Human Resources that they were sent home and are responsible for following up with their primary care physician if needed.**
Person Performing Screening: ____

XVIII. ANNEX D: ANTICIPATING THE RETURN TO A NEW NORMAL—STEPS COMPANIES SHOULD TAKE TODAY TO PROTECT THEIR WORKFORCE TOMORROW

As states around the country begin to lift and lessen existing shelter-in-place and stay-home orders, employers are now confronting new challenges: when and how can they safely return employees to the workplace, who returns when and what happens if employees cannot, or do not want to return on the employer's timetable? The answers to these questions vary by location, industry, and company, but in developing a plan to reopen the workplace, employers should consider the following:

A. **WHEN?**

Deciding when to reopen the workplace is a complex decision, and employers must weigh health and safety concerns against business necessity, while monitoring constantly changing federal, state, and local orders and guidance. Though employers will need to make individualized determinations about when it is appropriate to reopen, the following are some of the key considerations:

1. Have federal gating criteria found in the White House's "Guidelines for Opening Up America Again" been met in the relevant jurisdiction (state-wide, or locally)?
2. What are state and local authorities ordering and/or recommending?
3. What are the potential publicity / PR implications connected to timing of opening and possible second wave of infection?
4. What changes/modifications will need to be made to the workplace to safely accommodate employees and customers, and how long will these changes take?

B. **WHO?**

Given employee health and safety concerns, the variance in shelter-in-place and stay-home orders across the country, the availability of childcare, the nature of certain employees' work, and the varying degrees of necessity for certain employees to return to the workplace to perform their jobs, it is likely that not all employees will return to the workplace at once. As employers decide which employees to bring back to work, they should:

1. Consider whether government orders restrict who can and cannot return and with what conditions.
2. Determine whether employees will return on a voluntary basis or based on other criteria, such as seniority or business function.
3. Evaluate which business functions and/or individual employees must be physically present in the workplace, considering the nature of the job.
4. Assess whether business needs upon re-opening may require the return of furloughed or laid off employees, and plan for returning and/or re-onboarding those individuals.
5. Consider how to respond to employee requests to continue working remotely. Companies should:

    a. Assess the impact of a remote workforce on company management, communication, and staffing.
    b. Ensure HR teams are prepared to respond to requests for COVID-19 related accommodations, flexible work arrangements, and leave.
    c. Determine whether there is an obligation to reasonably accommodate such requests. Employers have a legal obligation to reasonably accommodate only certain individuals, such as individuals who qualify as disabled under the ADA or relevant state laws. However, the White House "Guidelines for Opening Up America Again" suggest that employers should

consider accommodating those that are at high risk from severe complications from the virus, such as those over the age of 65 or those with certain pre-existing health conditions.

6. Ensure decisions regarding employee return dates are non-discriminatory. Keep in mind potential EEO issues, including:

    a. Disparate treatment. Be mindful not to base decisions concerning who will return on protected categories, even if the decisions are made to protect vulnerable groups.
    b. Disparate impact. Consider an adverse impact analysis. Ensure decisions are defensible on a business necessity basis.

7. Consider staggering return dates and/or allowing certain employees to continue remote work to limit or prevent the spread of coronavirus.

    a. Business continuity may depend on having redundant systems in place to ensure viability if one team must leave the workplace because of exposure to a co-worker who tests positive.
    b. Determine whether employees can be segmented into groups or shifts that do not intermingle (e.g., separated by physical workspace, or workdays).

8. Consider applicable recall rights and any prescribed order if employees are subject to a collective bargaining agreement or other local ordinance.

C. **HOW?**

"How" to return employees to the workplace will be a complex process, and will vary based on business needs, the relevant regulations in the areas in which the employer conducts business, as well as individual health and safety concerns. The following are critical—but not exhaustive—steps to take in this process:

1. Communicate with employees about the return to work.

    a. Regularly communicate with employees to explain the timeline for returning to the workplace and the company's steps to ensure employee safety.
    b. If the workforce is unionized, ensure you are following the collective bargaining agreement and communicating with the union prior to communicating with employees.

2. Prepare for logistical issues.

    a. Work with company IT and HR to reinstate access to company property, materials, and resources to applicable employees.
    b. Update HR policies and employment agreements to reflect any changes to leave, remote work, or healthcare policies the company has adopted in response to the pandemic, with the assistance of qualified counsel.
    c. Consider how best to protect trade secrets as employees return to work, including recovery of any company files, equipment, or sensitive information the employee may have printed, and work with IT to ensure the forensically sound remediation of any data from employees' devices.

3. Expect requests for leaves of absence and/or workplace accommodations. Companies should create, train, and communicate company reporting protocols to:

    a. Allow employees to request leave or other workplace accommodations or report workplace safety concerns.
    b. Evaluate requests in a non-discriminatory manner.

c. Properly record and maintain information, and safeguard the confidentiality of medical information.
d. Make changes to the procedures and policies where necessary.

4. Issues to anticipate:

   a. Employees who are unable to return to work due to lack of available or satisfactory childcare or care for other dependent family members. Employees may be eligible for paid or unpaid leave under the Families First Coronavirus Response Act, the Family Medical Leave Act, state and local paid sick leave laws, and other state and local laws (such as laws that require employers to provide time off for certain school activities). State and local laws are revised frequently, and should be regularly consulted for updates.
   b. Pregnant employees. Though pregnancy is not a disability under the ADA, some pregnancy-related medical conditions can be ADA-protected disabilities that trigger ADA accommodation rights. Pregnant employees may be entitled to leave and/or workplace accommodation in certain states as well. Consult state and local law for guidance.
   c. Employees with a disability. Conduct an individualized assessment, engage in an interactive process, and make reasonable accommodations that would not impose an undue hardship.
   d. Employees who are "high risk" under federal, state, and local guidance but otherwise able to work. EEOC guidance under the ADA provides that employers are not required to grant accommodations to older employees simply because the individual is at greater risk of serious illness from COVID-19 due to his or her age. Employers should review the CDC and White House guidance for high-risk populations, including "older adults and people of any age who have serious underlying medical conditions," and consider whether accommodations are feasible, practical, or individually necessary. While employers may advise all employees, including "high risk" employees, that a leave may be available, an employer should not exclude employees who are "high risk" from the workplace when the employee has not requested a leave.
   e. Employees who fear they will contract COVID-19 if they return to work or resume use of public transportation for commute. Generally, employers do not have an obligation to accommodate employees who are not disabled but who have generalized fears of returning to work. Employees falling into this category who still refuse to return to work may be entitled to paid or unpaid leave. OSHA permits employees to refuse to work if they believe they are in "imminent danger," which is defined to include "any conditions or practices in any place of employment which are such that a danger exists which could reasonably be expected to cause death or serious physical harm immediately or before the imminence of such danger can be eliminated through the enforcement procedures otherwise provided by this Act."
   f. Employees engaged in protected concerted activity. Union and non-union employees may be protected under Section 7 of the NLRA in the event workers refuse to work, strike, walk out, or simultaneously call in sick, but an extended duration, unique circumstances, or a pattern of such activity may not be protected.

5. Address employee benefits and compensation issues.

   a. Consider whether the company needs to change health/retirement plans based on relevant state and federal laws, whether employees will need to update or re-enroll in prior plans, and whether furloughed employees owe healthcare premiums from the time during which they were furloughed.
   b. Determine if existing bonus or incentive plans were impacted by the shutdown, and assess whether payments must change as a result of factors like reporting time, show up pay, split shifts, or continuous workday.
   c. If any shift differentials, bonuses or "hazard pay" are awarded, consider implications on regular rate calculations for non-exempt employees.

   d. If jobs are restructured, ensure that salaried employees continue to be properly classified as exempt.

6. Establish a workplace safety policy to protect employees and functions from widespread infection.

   a. As discussed in Paul Hastings' April 13, April 16, and April 20 client alerts, companies should review applicable CDC, OSHA, federal, state, and local guidance regularly to ensure the company is following the most up-to-date best practices.
   b. Consider the particular jobs, tasks, structure, floorplan, and activities that occur in the workplace and assess the potential for exposure to COVID-19 and necessary response measures.
   c. Review current safety policies, procedures, and training materials to determine if they need to be revised or adjusted in light of the pandemic.
   d. Create, train, and communicate company reporting protocols for responding to safety complaints and concerns.
   e. Evaluate whether changes to the heating, ventilation, and air conditioning (HVAC) system are necessary.
   f. Assess and implement measures that allow employees to maintain a minimum distance of at least six feet from other persons (where possible), such as increasing space between employees; installing Plexiglas or other barriers; staggering shifts, meal and break times; training employees on best practices for hygiene; limiting in-person meetings, visitors, and number of attendees.
   g. Discontinue nonessential travel.
   h. Review and establish appropriate cleaning and disinfection routines and ensure compliance with the CDC's "Guidance for Cleaning and Disinfecting Public Spaces, Workplaces, Businesses, Schools, and Homes."
   i. Retain the services of an environmental health consultant, if necessary.
   j. Work with counsel to identify industry-specific areas of liability.
   k. Decide whether to use face covers and Personal Protective Equipment based on job hazards and government guidance.

7. Monitor employees after return to work.

   a. Determine whether it makes sense from a financial/liability perspective to implement symptom checks, temperature screening, or other COVID-19 testing for employees and ensure compliance with relevant governmental, CDC, and local public health regulations, as well as confidentiality and privacy considerations, for the tests.
   b. Determine whether the safety measures discussed above will impact normal operations, including wage-and-hour issues associated with pre- and post-work activities for non-exempt employees, and plan to adjust accordingly.

8. Create future-looking plans for how to deal with another pandemic.

   a. Analyze successes and failures in responding to the pandemic and create or supplement company policies and procedures based on that information.
   b. Establish a crisis response team.
   c. Improve remote working capabilities.

9. Develop a plan for use in the event an employee tests positive for or is showing symptoms of COVID-19.

For more information and assistance, please contact Paul Hastings' Employment Law Department or visit paulhastings.com/coronavirus.

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