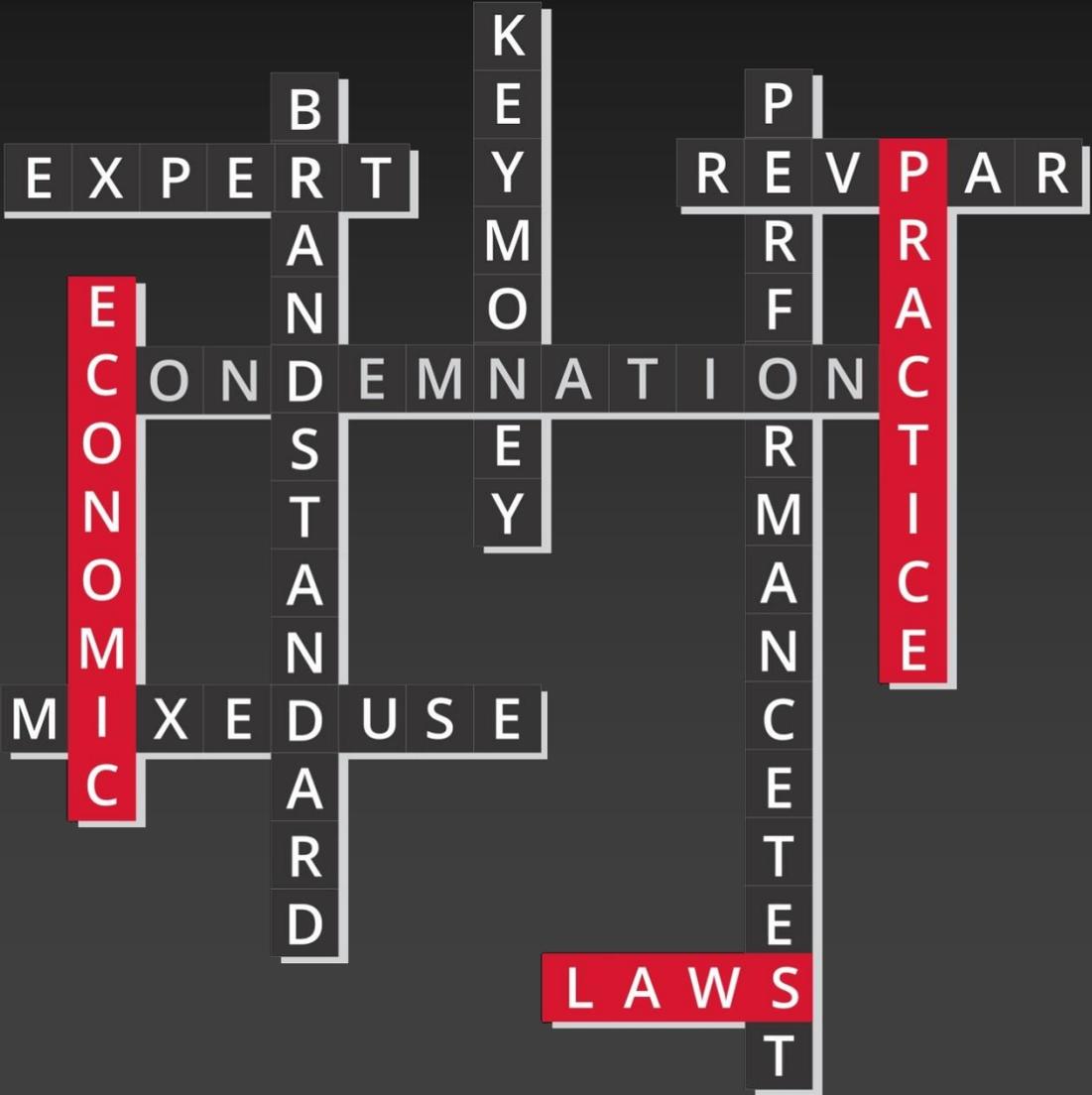




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Table of Contents

Preface	4
Investment and Acquisition of Hotels.....	5
Sources of Funding and Applicable Regulations.....	5
Issues in Investments and/or Acquisitions of Existing Properties	7
Restrictions under HMAs	8
Debt Funding in the Hotel Industry	9
Terms and Covenants of Financing	11
Competition Law and the Hospitality Industry in India	13
CCI's Merger Control Record in the Hospitality Sector	14
Taming the HMA Beast – Issues in HMA.....	15
Limitation on the Rights of the Manager	15
Control Rights to Owners	16
Non-Disturbance Agreements.....	17
Exit Rights.....	17
An Alternate Arrangement – Hotel Franchising.....	20
Brand Standards.....	20
Liquidated Damages.....	20
Restrictions on Transfer of Interest.....	21
Protected Areas.....	21
Employment Relationship under HMAs.....	23
Master- Servant Relationship.....	23
Vicarious Liability	24
Data Privacy Legislation in India and Ownership of Guest Data.....	25
Ownership and Nature of Guest Data	25
Data Privacy Laws.....	26
Data Breaches	27
Dispute resolution Clauses in HMAs	29
Institutional or Ad hoc Arbitration	29
Method of Selection and Number of Arbitrators	29
Arbitration Rules	30
Language of the Arbitration	30
Place of the arbitration	30
Enforcement and Annulment/Setting aside of Awards.....	31

Expert Determination in HMAs	31
Will GST Show Some Hospitality to the Sector?	35
Implications under the Existing Regime	35
Proposed GST Regime	36
Note on GATS.....	39
Introduction	39
Services Covered	39
Tourism and Hospitality Services	40
Future Tense – Evolving Business Models in Hospitality	42
Understanding the Model	42
Issues arising in New Models	43
Delays in Hotel Construction Projects.....	44
Insolvency and Bankruptcy Code, 2016	47
Did You Know?	51
Abbreviations	54
Acknowledgement	56
Notes	57

Preface

Lawyers enjoy a little mystery, you know. Why, if everybody came forward and told the truth, the whole truth, and nothing but the truth straight out, we should all retire to the workhouse

~Dorothy L. Sayers

We are delighted to bring you ELP's guide to “**Hospitality – Indian Legal Issues**” which highlights the important Indian legal issues that impact the Hospitality Sector. The laws and contracts that govern the relationship between hotel owners, operators, guests and hotel financiers are not taught at Law School or College. Therefore, we have had to draw upon our experiences from the 75 hotel transactions that we have been a part of over the last 15 years. For this experience we are indebted to numerous clients who have entrusted us with negotiating and drafting contracts and structuring transactions that are meant to live through decades. As the industry grows through innovation and user preferences, the law will always be playing catch up. It is therefore even more important that lawyers work closely with operators and owners to cater to the future through robust contracts.

The subjects covered in this guide range from the basic Hospitality Management Agreement (“HMA”) to the GATS regime and many issues in-between. This guide would not have been able to cover such varied topics without the efforts of the specialists that together form the team at ELP.

We do hope this makes for some interesting reading. We respect every reader’s opinion and your feedback is welcome.



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Investment and Acquisition of Hotels

"In investing, what is comfortable is rarely profitable"

~ Robert Arnott

India is no stranger to hotel investment and acquisition transactions. Several existing hotels, as well as those under construction, have attracted investments and acquisitions from both domestic and foreign players. Some of these transactions are high value and very visible, with marquee hotels changing hands. Institutional investors/ owners have emerged that have a large portfolio of hotels, often through acquisitions of operating hotels. Certain hotel management companies (both domestic and foreign) have themselves owned or invested in hotels in India. Owners/ acquirers rely on both equity and debt funding for such transactions. Given the limitations and risks of both equity and debt, other options for hotel funding are also being explored.

Sources of Funding and Applicable Regulations

Finance being the lifeblood of any commercial enterprise, it is important for hotel developers and/or owners to understand the sources of financing and their limitations. Similarly, investors and/or acquirers also need to bear in mind the avenues and regulatory limitations for their investments.

Domestic Equity

There are no specific provisions applicable to investment through equity by domestic investors or acquirers in hotel assets in India. Other than adherence to the provisions of the Companies Act, 2013 ("Companies Act") relating to subscription or purchase of equity securities, there are no requirements that need compliance. Where equity transactions involve acquisition of listed Indian entities, investments and acquisitions over the prescribed threshold of 25% (twenty five percent) or acquisitions of control (which may not involve acquisitions over 25% (twenty five percent) of the share capital of the target) would trigger open offer provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011 ("SEBI Takeover Regulations") issued by the Securities and Exchange Board of India ("SEBI"). Even where the aforesaid threshold is not breached or control is not acquired, there are disclosure requirements for acquisitions at different thresholds. Indirect transfers are also covered by the SEBI Takeover Regulations.

Foreign Equity

Foreign direct investment ("FDI") is permissible up to 100% (one hundred percent) of the equity in a hotel-owning company or a limited liability partnership. Hotel investments are considered as investments in construction development projects under the FDI policy issued by the Government of India ("GoI") and as such are subject to the conditions applicable to all construction development projects. However, hotel projects are entitled to certain relaxations as compared to other construction development projects. Most significantly, investors in hotels are able to exit from hotel projects prior to completion of three years from the original investment as required of other projects. However, foreign investors would need to keep in mind the pricing guidelines which restrict foreign investors from acquiring equity securities in Indian companies at a price lower than the fair value. Additionally, exit by way of transfer of equity securities to a resident would need to be at a

value not more than the fair value of such securities. These restrictions also apply to what is known as downstream investments, under the FDI policy, that is, investments by an Indian entity owned or controlled by non-residents into another Indian entity.

Apart from the FDI route, foreign investors that are registered as foreign institutional investors (“FIIs”) or foreign portfolio investors (“FPIs”) may invest through the Portfolio Investment Scheme (“PIS”) route. Under PIS, the individual holding of an FII and/or FPI cannot exceed 10% (ten percent) of the capital of the company and the aggregate limit for FII and/or FPI investment cannot exceed 24% (twenty four percent) of the capital of the company (which may be increased to the sectoral cap subject to the approval of the Reserve Bank of India (“RBI”). Only registered FIIs and FPIs can trade and invest in securities through a registered broker on stock exchanges in India. Other foreign investors may acquire securities of listed companies through off-market transactions.

In any case, acquisitions by foreign investors would always be subject to the provisions of the SEBI Takeover Regulations.

Debt Financing

This is separately covered in chapter on Debt Funding in the Hotel Industry at page 8.

Real Estate Investment Trusts (“REITs”) and Infrastructure Investment Trusts (“InvITs”)

To encourage investments in the real estate and infrastructure sectors, SEBI introduced REITs and InvITs as alternate investment structures to be set up as registered trusts through the Real Estate Investment Trust Regulations, 2014 (“REITs Regulations”) and the Infrastructure Investment Trust Regulations, 2014 (“InvITs Regulations”) respectively.

A REIT can only invest in real estate properties located in India, either directly, or through holding companies or special purpose vehicles with at least 80% (eighty percent) of the value of the REIT assets being invested in completed and rent-generating properties within the framework provided under the REITs Regulations. Real estate, for the purpose of REITs, include land and any permanently attached improvements to it whether leasehold or freehold including buildings, sheds, garages, fences, warehouses, and car parks but excludes mortgage other than infrastructure. However, hotels and convention centres forming part of composite real estate projects, industrial parks and special economic zones would be deemed to be REITs.

Similarly, an InvIT can only invest in infrastructure projects or companies with at least 90% (ninety percent) of its assets comprising infrastructure projects within the framework provided under the InvIT Regulations. Infrastructure for the purpose of the InvIT Regulations includes certain categories of hotels.

Both REITs and InvITs are required to undertake listing of its units within 3 (three) years of being granted a certificate of registration from SEBI and access the market subject to the conditions set out in the relevant regulations.

REITs are required to invest at least 80% (eighty percent) in completed rent or income generating properties. Additionally, not more than 20% (twenty percent) of the value of the REIT asset should be invested in under construction projects or completed and not generating rent properties, government securities, money market

instruments or cash equivalents, listed shares of companies deriving at least 75% (seventy five percent) of their operating income from real estate activities and listed or unlisted debt of companies or body corporate in the real estate sector, excluding investments made in the debt of the holding company and/or Special Purpose Vehicle. ("SPV").

Similarly, an InvIT is required to invest a minimum 80% in completed and revenue-generating infrastructure projects and maximum 20% of the value of the InvIT assets shall be invested in other eligible investments including investments in under construction projects, which shall not exceed 10% of the value of the InvIT asset.

Although REITs and InvITs offer an alternate method of accessing the market and pooling together funding from retail investors, there has been no real progress in the actual establishment or listing of REITs and InvITs. SEBI has brought in several amendments in order to smooth over the concerns that have kept developers away from this method. However, issues such as tax treatment, stamp duty and high thresholds for investment in already developed projects (for which major financial requirements would possibly have been met), are still unresolved.

Issues in Investments and/or Acquisitions of Existing Properties

Although no transaction is exactly like the other, certain risks are typical of hotel investments and acquisitions. Some of the issues are set out below in brief.

Leveraged Assets

Given the high costs of acquisition of real estate and ballooning construction costs, hotel properties are often heavily leveraged. Often, there are longstanding payment defaults leading to institutional lenders designating their debt as 'nonperforming assets' or NPAs that then restrict the promoters of the owner entity from transferring securities or ceding control by way of further investments in the owner. Renegotiation with lenders is often a large part of an acquisition. Sometimes the hotel assets are subject to restructuring under the Corporate Debt Restructuring Scheme or joint lenders' forum under the applicable norms issued by the RBI that affect the flexibility in structuring the acquisition transaction. Further, the new Insolvency and Bankruptcy Code, 2016 could have some bearing given that if a petition for insolvency is presented in a national company law tribunal and an insolvency professional is appointed, any sale of assets would have to form part of the scheme for revival of the owner entity, at first instance.

Land Title

Given the multiplicity of land laws, the historical nature of land holdings, and devolution of small scattered holdings in the name of individuals without adequate paper trails, the acquirer of, or investor in, any business that relies on any real estate asset, should employ adequate time and resources to ascertaining the quality of the title of land. Where land is leasehold, the term of lease and the likelihood of renewal would also need to be factored in. Restrictions on transfer of interest in leasehold land are often incorporated in government leases. Litigation would also adversely affect title, and in the absence of accessibility to court records, the reliability of the owner could be tested.

Third Party Consents

Third party consents from lenders and lessors may be required in case of acquisition of substantial shareholding or control over an owning entity. Additionally, consents from various authorities for hotel operations may need to be examined to verify whether there are any requirements to obtain consents or intimations to the relevant authorities.

Diligence Issues

As under any other acquisition or investment, the acquirer undertakes diligence of the target. Such diligence may throw up issues for the acquirer to consider while making its decision to purchase or invest. These issues could lead to a reduction in the asking price or obligations on the target and promoters to 'clean house' or mitigate their effects. However, communication of information by persons associated with the company to acquirers and their advisors would need to be seen through the lens of insider trading regulations in India. The Companies Act restricts disclosures of price sensitive information unless such disclosure is in the ordinary course of business. Additionally, the SEBI (Insider Trading Regulations), 2015 also prohibits the disclosure by insiders of price-sensitive information unless such disclosure is in the furtherance of a legitimate purpose or in the course of the insider's duties. Given these sweeping restrictions, the scope of due diligence of listed entities may need to be more limited than as may be desired by the acquirer. Where such acquisition results in a takeover offer, then the target is permitted to make such disclosures, since the same information would then be available to all other investors. However, where no such takeovers offer results, the issue still remains. Further, it may not be in the interest of the target to have disclosed all price sensitive information to the public.

Competition

Certain large transactions would trigger the combination provisions of the Competition Act, 2002 ("Competition Act"). This is discussed in more detail in the chapter on Competition Law and the Hospitality Industry in India at page 12.

Restrictions under HMAs

Hotel Management Agreements ("HMAs") typically have restrictions on the ability of the owner to transfer the hotel. Indirect transfers by way of transfer of interest in the owner entity are also prohibited. There are restrictions from transferring interest to certain persons who are prohibited under foreign laws (relating to anticorruption or Financial Action Task Force ("FATF") or even to persons that, in the opinion of the managers are undesirable.

Understandably, developers have reservations signing up to such restrictions as their ability to exit is hampered by such wide and often subject restrictions. Owners are often hesitant in agreeing to adhere to laws to which they are not subject. Further, since indirect transfers are also restricted, where hotel owning entities are owned directly or indirectly by listed entities (which now would include REITs or InvITs), it may be practically impossible to comply with such HMA restrictions.

Consent of the manager for acquisition of a substantial stake may therefore be a prerequisite to a hotel investment or acquisition transaction. The acquirer may have to submit itself and its officers and/or shareholders to a diligence process to satisfy the manager of their bona fides and compliance with certain foreign regulations.

Debt Funding in the Hotel Industry

"If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has."

~ J. M. Keynes

The success of a hotel depends on multiple factors, such as its location, occupancy levels, category, competency of the hotel operator, amenities, growth of tourism, economic growth of the jurisdiction, global economic situation and also a sound financing plan.

Debt funding to the hotel industry has increasingly created a niche, with financial institutions undertaking specific scrutiny, to better understand and create specific structures/covenant/processes for the industry. It has been noticed that it makes more commercial sense to approach a financial institution that has a clear understanding of the hotel industry, rather than only availing of a simple corporate credit facility.

The approach of financial institutions for financing the hotel industry is highly dependent on (i) the purpose of financing, and (ii) the stage that the hotel and/or project are in. Some of the requirements and stages are elaborated below:

Land Acquisition and/or Hotel Acquisition

In both the cases mentioned above, the financial institutions treat the debt funding as a case of acquisition finance. Some of the interesting issues are noted below:

- banks refrain from doing direct financing of promoter contribution for the acquisition, considering that the RBI has not been viewing such transactions favourably;
- it is usual practice that the acquirer and/or owner of the hotel are a newly-formed company and/or special purpose vehicle. In such a scenario, the lenders seek comfort from the group and/or the parent entities;
- as stipulated by RBI, the financial institutions do not lend against the primary security of shares, and therefore, the immovable and/or movable property forms the main comfort;
- the target entity cannot provide security and/or contractual comfort in such acquisition financing structures, owing to the financial assistance rules under the Companies Act, 2013; and
- owing to the increase in real estate costs, the stamp duty, other indirect tax levy and registration costs in most locations in India, the acquisition of land has become a costly affair. The stamp duties and registration costs alone may increase the acquisition cost by up to 10% depending on the location. However, the higher Floor Space Index ("FSI") (that is, the quotient obtained by dividing the total covered area (plinth area) on all floors, excluding exempted areas as given in relevant development regulations by the area of the plot.) available for hotels in most states in India provides some shade in the sunlit path. Most of the states provide for exclusion of certain areas from being considered for calculation of the FSI in starred hotels. Prior to acquisition, it should be ensured that the legal due diligence in respect of the permits, consents, licenses, and so on, are also done in addition to the title of the property. This due diligence is also helpful for the future, and helps in ensuring that the due diligence of future financiers is smoother.

Construction of the Hotel

Generally, lenders tend to approach financing at this stage, but face similar issues as faced for construction finance. One of the differences though, is that there is no separate mortgage of units and release of mortgage required (like for residential and/or commercial projects) for hotels under construction. The structures are highly dependent on who the borrower is, whether the owner of the land, the parents in the joint venture entity, a developer having the right to develop the hotel, the construction contractor, and so on. At this stage, it is very important for the lenders to ascertain that all the required approvals are in place and that the project has achieved financial closing (in the form of clear commitments) before disbursing any money. The lenders insist on receipt of equity contribution before the debt is disbursed. The lenders ensure that they closely monitor the cash flows and the expenditure in the project. Lenders also look to provide the non-fund-based funding requirements of the borrowers at this stage.

Renovation/Refurbishment/Expansion

At this stage, the borrowers look for a certain amount of top-up funding or look to refinance the existing debt exposure with an increased limit. In such situations, it would be important for the borrower to analyse the prepayment conditions under its existing facilities. Sometimes, prepayment premiums charged by existing lenders completely change the costing of a refinancing structure. In such a stage, lenders also analyse whether the refinancing and the re-jigging proposed would lead to “restructuring” and therefore, an increase in provisioning for the lenders.

Working Capital

Similar to all businesses, financiers provide the regular working capital limits to this industry.

- **Infrastructure Sector:** The primary boost that has been provided to the hotels is that the RBI regulations have included this sector under the definition of “infrastructure sector”. In its efforts to boost the infrastructure sector, the regulations provide a liberalized approach for financing the infrastructure sector. Accordingly, this allows the hotel industry to access longer tenure debt and cheaper debt facilities. It also provides the lenders with a less stringent approach qua provisioning of the facilities to this sector. Hotels also have access to foreign debt through external commercial borrowing (“ECB”), under the automatic route, as regulated by the Master Directions of ECB issued by the RBI (“ECB Regulations”). In certain situations, ECB along with relevant hedging facilities still allow for access to funds cheaper than rupee debt for borrowers.
- **Bond Financing:** Corporates are now increasingly analysing structures around bond issuances as a means of raising debt. Some of the key factors that are attracting corporates for bond issuances are as follows: (i) push given by the government in trying to uplift India’s corporate bond market, (ii) relaxation in norms around foreign investment into the corporate bond market, thereby allowing access to a larger market of lenders, (iii) secured, rated bonds having an interest coupon, which is cheaper than rupee term loans and (iv) availability of flexible coupon structures or hybrid security structures to suit varied commercial requirements.

Within the domestic market, bond financing has mostly been in the form of secured non-convertible debentures, issued under the private placement route. Private listed companies no longer need to have the

non-convertible debentures listed, as was required earlier. Additionally, the companies are also evaluating issuing rupee bonds under the ECB Regulations, also known as “*masala bonds*”. The primary feature of such bonds is that the currency risk is to rest with the lender and/or investor and should not be passed on to the issuer.

Terms and Covenants of Financing

In addition to the standard terms and covenants including creation of security over all hotel assets (and additional collateral, guarantee and comfort letter from the parent entity or promoters in certain cases), the following terms are considered in a hotel industry:

Hotel Management Contracts

For all cases where there are hotel operators in the project, the analysis over the HMA forms an extremely important stage to finalise the structure and the covenants applicable. The arrangement with hotel operators provides for one of the few situations in the financing space wherein market practice suggests that the operator will continue with its right to receive the cash flows even though the lender is not receiving its repayment. In fact, in certain situations, hotel operators also negotiate for agreements like non-disturbance agreements (“NDA”) wherein the operators’ right is not disturbed, even in case of an event of default or in case of an enforcement and transfer of ownership. The lenders have tried to push back on NDA. However, they have agreed that operators have a priority in the waterfall of payments. In some situations, lenders have also agreed with the hotel operators that they will not initiate any action to freeze accounts in case of enforcement of security.

Escrow Mechanism

Unlike other projects, it is important to ensure that the waterfall mechanism of the escrow or the collection accounts should be tailored to ensure that the lenders have interest only on the owner’s share of collection and that the operators’ shares are paid out to them as a priority, since any dispute with the operator would directly impact the overall business of the hotel. In order to effectuate operational ease, lenders have agreed on complex sub account operations within the escrow account, which allows for automated releases and automated transfers.

- **Debt Equity Ratio:** This is one of the most important covenants, as most hotels generate revenues in the long term and high interest burdens can make the project unviable. Most banks would insist that at least a sum equivalent to soft costs including consultant fees, interest during construction, land cost, and so on, is brought in by promoters as their equity and/or contribution to the project, and that the promoters should not withdraw their contribution prior to complete repayment;
- **Date of Commencement of Commercial Operations:** This is an important covenant in the financing of any project, including hotels. As per the guidelines issued by the RBI on asset classifications, loan for infrastructure projects (which include hotels) is to be classified as an NPA if it fails to commence commercial operations within two years from the original Date of Commencement of Commercial Operations (“DCCO”), despite no financial default. There is only a one-time relaxation to requalify the same as standard assets by restructuring as per the RBI guidelines;

- **Average Occupancy and Room Rents:** Given the nature of the business, this is a financial covenant laid down by most bankers to ensure that the long-term feasibility and growth of the hotel is achieved;
- **Prepayment Terms:** Given the fact that the financing of hotels are generally long term in nature, one should always consider negotiating favourable terms for prepayment, which is helpful in ensuring that refinancing may be done without huge pre-payment penalty in the event that the financing market turns more favourable during the loan tenor.

In addition to the aforementioned points, it becomes important to structure the transaction documents to ensure that they are most cost-effective in terms of stamp duty, registration, and so on. This would include determining and negotiating the type of mortgage, merging the security documents of movable and immovable assets in a single document, choosing the place of execution and the jurisdiction of the documents. Given the fact that stamp duty in India is a state subject, merely the location may make a huge difference in the cost involved in financing.

One of the most important concepts which govern financing structures for this industry is the concept of “maintaining business continuity”.

Competition Law and the Hospitality Industry in India

“As a freak legislation, the antitrust law stands alone. Nobody knows what it is they forbid.”
 ~ Isabel Paterson

Accounting for over 7.5% of India’s Gross Domestic Product (“GDP”), and expecting a year-on-year growth of 7.2% per annum (“p.a.”) in the coming years, the tourism and hospitality industry in India is thriving. The Indian tourism and hospitality industry is among the top 10 sectors in India in terms of the volumes of Foreign Direct Investment (“FDI”). The GoI’s liberal investment policies, robust initiatives to boost investment, and a surging demand among domestic and foreign travellers makes this sector both competitive and conducive to foreign investment. The fragmented nature of this sector and the presence of small and unorganised players also result in considerable space for consolidation.

At this stage, the perspective of India’s market regulators towards the hospitality industry becomes significant. Entrusted with the regulatory task of promoting and sustaining competition in markets, the Competition Commission of India (“CCI”) has had a few, but limited opportunities to deal with the hospitality sector. A few important aspects of India’s antitrust enforcement in the hospitality sector are discussed below.

Notification to the CCI – Jurisdictional Thresholds

Any acquisition of control, shares, voting rights or assets and any mergers and amalgamations which cross the jurisdictional thresholds specified in the Competition Act (read with GoI notifications) must be reported to the CCI. The Act adopts a suspensory regime, and as such notification is compulsory. The jurisdictional thresholds in India adopt the ‘size of parties’ test; and transactions which meet any one of the following thresholds must be notified to the CCI:

Companies party to M&A or Acquisition			Groups (2 or more enterprises) party to M&A or Acquisition		
In India			In India		
Assets	OR	Turnover	Assets	OR	Turnover
> INR 20 billion (INR 2000 crores)		> INR 60 billion (INR 6000 crores)	> INR 80 billion (INR 8000 crores)		> INR 240 billion (INR 24,000 crores)
In India & Outside India (aggregate)			In India & Outside India (aggregate)		
Assets	OR	Turnover	Assets	OR	Turnover
> USD 1 billion (Including minimum		> USD 3 billion (Including minimum	> USD 4 billion (Including minimum		> USD 12 billion (Including minimum

INR 1000 crores in India)		INR 3000 crores in India)	INR 1000 crores in India)		INR 3000 crores in India)
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The GoI has also extended the *de minimis* exemption (or the “Target Exemption”) till March 2021. According to the Target Exemption, any acquisitions of shares, voting rights, control, or assets need not be notified to the CCI if the enterprise which is being acquired has:

- assets not more than INR 3.5 billion in India; and/or
- a turnover of not more than INR 10 billion in India.

Target Exemption, however, does not apply to transactions structured as mergers or amalgamations.

CCI’s Merger Control Record in the Hospitality Sector

In early 2016, the CCI cleared the acquisition of Starwood Hotels & Resorts Worldwide, Inc. by Marriott International, Inc. In India, Marriott manages hotels under several of its brands such as the Ritz-Carlton, Bulgari, Edition, JW Marriott and Marriott Hotels. Starwood, on the other hand, is engaged in operating, franchising and licensing hotels such as Le Meridian, Sheraton, St. Regis and Westin.

Starwood and Marriott, in their notice, proposed the relevant market to be market for hotels in different cities in India; and alternatively suggested a narrower market definition of four and five star category hotels. The CCI, in its assessment, did not feel the need to define a relevant market, since the combination did not raise competition concerns regardless of a market definition. The CCI noted the presence of competing large players in the four and five star hotel segment such as The Indian Hotels Company Limited (Taj Group), The East India Hotels Company (The Oberoi Group), The Leela Group of Hotels, Lemon Tree Hotels, Park Hotels, The Radisson Hotels, Hilton, Hyatt, the Intercontinental Hotel Group to name a few and was of the view that the combination did not have an appreciable adverse effect on competition in India.

In 2015, the CCI also cleared acquisition of the Leela Goa, by Ceres Hotels Private Limited, by way of a slump sale. Due to an absence of any horizontal or vertical overlap between the parties, the CCI decided that the combination did not cause an appreciable adverse effect on competition in India.

While assessing the impact of transactions on competition in India, the CCI has pragmatically acknowledged the competitive nature of the industry and the presence of large players in the four and five star segment. The competitive landscape in this sector will be further strengthened with consumers having the advantage of information symmetry from emerging travel aggregators and hotel comparison platforms such as ixigo.com, trivago.com TripAdvisor, and so on. As such, the CCI is likely to continue with a liberal outlook in examining the hospitality industry in future transactional and behavioural enquiries that it undertakes. Although the CCI refused to define a relevant market in the Starwood/ Marriott acquisition, the CCI may examine future transactions in segment-based product markets at city-level geographies. This, however, must be assessed on the basis of the facts of each case.

Taming the HMA Beast – Issues in HMA

“It's the little things that make the big things possible. Only close attention to the fine details of any operation makes the operation first class.”

~ J. Willard Marriott

HMA's are a peculiar form of contract involving a complex array of documentation – the operations agreement, the license agreement, the technical specifications agreement and the centralized services agreements.

Managers, often running multiple hotels in multiple jurisdictions, and often, even within the same jurisdiction, come to the table with their standard form on contract containing little room for variance. This leaves the person with the most skin in the game, that is, the owner, with very little say in how his asset is to be managed. This may be attributed to the fact that a manager, in its vast experience of management, has figured out an optimal model agreement that works for what the manager is seeking to cover. Owners on the other hand, and in particular first-time owners, have limited knowledge with respect to running and operating a hotel and all that it entails. And thus, from the outset, there is a gap of understanding between the manager and the owner as regards industry standards of practice and the terms underlying the all-encompassing HMA.

Managing hotels and leisure facilities inevitably lead to a complex range of commercial and legal issues. These issues should be carefully managed at the outset to ensure a smooth partnership between the owner and manager.

A few of the issues that invariably come up are listed below.

Limitation on the Rights of the Manager

The manager under the HMA, typically enjoys unfettered rights to manage and operate the hotel in such manner as the manager deems fit. His argument usually is – I am the pilot of your plane, so let me fly it. From setting price policies and ancillary services for the hotel, to appointment and recruitment of hotel employees, everything is to be spearheaded by the manager. The owner has little control over human resource policies, vendors, from whom supplies are sourced, managing publicity and media for the hotel, management of bank accounts, and so on. From the manager's point of view, wider rights over management of the affairs of the hotel, is required for effective and efficient management of the hotel. However, from the point of view of an owner, being the chief financier of the hotel and its operations, a prudent owner wants to be assured of a return on his investment, and in turn, actively seeks certain restrictions to be placed on the rights of the manager under the HMA.

Limitations on the rights of the manager are typically found in the HMA's. These limitations take the form of restrictions on the manager in terms of financial expenditure beyond a certain threshold, entering into agreements with third parties beyond a certain term, and so on.

Often, these limitations are superficial, and are agreed to by the manager with large caveats. Also, whether these limitations are effective in restricting the manager in real terms, is a question often posed. We believe that there may be better mechanisms for permitting the owner to have more say in the HMAs other than merely placing these limitations on the manager. However it must be balanced such that the manager is not unduly restricted from doing what he is best at – operating hotels.

Control Rights to Owners

On the side of owners, it seems we have entered a time of increasing analysis of the bottom line performance of their hotels. HMAs that were often signed based on the implicit trust in the managers, as well as the lack of availability of advisors to the owners, have had to undergo significant changes.

Owners have gained valuable experience, as well as access to specialized advisors, and this combined with the increase in the number of managers in the market have given the owner greater bargaining power in the negotiation process.

We have observed that hotel asset owners seek greater inclusion in the management of the hotel, as they are generally financing the construction, management and maintenance of the hotel. Owners like to ensure that their money is being spent well and with purpose. Focus on performance unsatisfactory to the owner often results in an enhanced sensitivity toward the management practices and conflicts of motivation that may contribute to such unsatisfactory results. This often finds expression in HMAs through approval rights to the experienced owner. Further, even today's first-time owner wants a seat at the table when it comes to major decisions, for example, preparing and approving the annual budget, major capital expenditure, implementing a change in brand standards, and so on.

The mechanism through which owners seek to exert control albeit limited; over their managers are approval rights. This finds a form under the HMA through approval rights over certain line items in the annual plan, thresholds for owner approval in respect of capital expenditure, monthly meetings with the general manager to review the performance of the hotel, and lock-in with respect to brand standards for a certain period of time post opening of the hotel.

It is a principle of contract law that all provisions of an agreement must be read together in order to understand the true meaning and essence of the contract, and the same holds true with the HMA. While a number of approval rights are granted to the owner, the managers also ensure that enough is held back to permit them to operate the hotel with as little interference from owners as possible. In fact, it has been our experience that managers do not shy away from the inclusion of a 'non-interference' provision in the HMAs, whereby what is to be construed as owners' interference in the managers operation of the hotel is defined in detail.

In order to balance these often seemingly opposed interests, it is important that both parties have meaningful rights under the HMA that are exercised with the interest of the hotel in mind.

Non-Disturbance Agreements

An increasing number of HMAs require the owner to obtain an NDA from the lenders of the owner in respect of the finance availed of for the acquisition of the underlying land or for the construction of the hotel. This tripartite agreement between the owner, manager and lender operates to bind the lender in the event of default by the manager or owner and the lender then takes over the hotel in accordance with the terms of the HMAs.

Managers insist on NDAs as they would like to have control over any potential transferee of the hotel – to ensure they have the financial wherewithal, is not a competitor; while the goal of the lender is simple – for borrowers to fulfil their obligations under the loan documentations and pay off at maturity. However, in the eventuality of foreclosure, lenders anticipate that a prospective buyer would like to terminate the hotel manager.

The middleman in this scenario, the owner, wants for nothing more than to be able to construct, build, equip and operate the hotel. They do not want their lenders to be uncomfortable with their managers, or for the terms of financing to be adversely affected.

Therefore, as an advisor, balancing the interests of all the parties is essential, and requires to be addressed in an effective manner as part of the overall relationship between the owner and manager under the HMA.

Exit Rights

There are limited exit rights available to the owner under any HMA. One rarely comes across an HMA where the owner may terminate for convenience or on sale of the hotel. In the event any manager agrees to the inclusion of the aforesaid, the same is coupled with a sizeable pay-out to the manager.

In case of sale of the hotel, the pre-condition is generally that the proposed transferee meets certain criteria and is agreeable to continue under the HMA as the owner of the hotel, and inherit all rights and obligations of the erstwhile owner. The combination of all these restrictions could lead to a real cost in the sale process for the owner, and could include a reduction in the price that the hotel could attract had it not been for such restrictions. The industry calls it 'vacant possession'.

Other exit rights available to the owner include a failure of the performance test by the manager. The provision of the performance test itself is riddled with so many terms and conditions that we are yet to see a termination on this basis. The conditions often include provisions whereby the performance test does not kick in until the fourth or fifth operating year, half years are not included, no year whereby the competitive set is incomplete can be included, and even then, if the manager fails the performance test, it may cure the same by making a payment to the owner. This greatly reduces the ability of an owner to terminate an under-performing manager. If the manager has wide cure rights, it may choose to simply buy its way out of trouble each time it fails the performance test.

With ownership of hotels changing hands during these unstable economic times, many HMAs are being renegotiated or new agreements are being entered into. It is during this time that owners and managers should

take a hard look at the performance test and negotiate language that is meaningful on a going-forward basis to ensure the optimum performance of the hotel and maximum accountability of the parties involved.

On a practical note, however, the owner should remember that managers don't want their flag to stay on an underperforming hotel and it is very unlikely given a choice, a hotel manager would insist on buying his way out of a performance test.

We have provided, as an annexure to this write up, a tabular representation of termination rights available to an owner via-a-vis brand operated as well as independently operated hotels¹.

Owners Termination under HMAs

	Brand	Independent
Without Cause		
▪ Frequency in Contracts		
- At any time	0%	42%
- After pre-determined period	15%	2%
▪ Required Notice Period (Days)	90 – 365	30
▪ Termination fee multiple	3-5	1-5
On sale		
▪ No operator option to purchase	35%	67%
▪ Operator option to purchase	56%	22%
▪ Operator option to continue	72%	38%
▪ Termination fee multiple	2-5	0.5-2.5
On Foreclosure		
▪ Frequency in contracts	80%	80%
▪ Termination fee multiple	0-2	0-1

In our upcoming editions, we will bring to light issues on the following topics:

- The Site: Design, Construction, Equipping and Furnishing the Hotel
- Operating Term
- Operations of the Hotel: Standards of Operation, Leases & Concessions, Bank Accounts, Consultation with operator, Agency Relations, Management Modules, Staff Facilities, Excuse of Performance
- Service Fee & Owner's Profit Distribution: Year End Adjustments
- Books and Records; Determination of Adjusted Profit
- Repairs and Changes
- General Covenants of Service Provider and Owner
- Insurance and Indemnity
- Damage and Destruction to the Hotel
- Condemnation
- Right to Perform Covenants and Reimbursement
- Defaults

¹ Source: *Hotel Management Contracts – Past and Present*, Jan A. deRoos (2010)

- Successors and Assigns
- Governmental Approvals

An Alternate Arrangement – Hotel Franchising

“Franchising is being in business for yourself, not by yourself”

~ Unknown

HMAs are typical arrangements between international hotel brands and managers and Indian owners. However, they are by no means the only kind of relationship between hotel brands and owners. Hotel franchising arrangements have made an inroad into the Indian market in the last few years as a natural consequence of its maturation. As brands have gained experience in managing Indian hotels and dealing with Indian owners and assets, there appears to be greater willingness to explore the hotel franchising model by both.

The word franchise comes from the French word *‘franchise’* meaning to liberate or set free, and it is for particularly this reason that Owners generally prefer the franchise model - they enjoy greater autonomy and control over finances. There also exists the potential of a lower cost. Hotel brands tend to be leery at times as their ceding control may impact standards. However, the advantages of reduced operational and regulatory risks are not lost upon them either.

A few of the issues that commonly arise in negotiating franchises are set out below:

Brand Standards

The cornerstone of a hotel franchise system is its brand, while one of the hallmarks of a franchisee agreement is that the owner typically has control over the management and operations of the franchise hotel. Managers are seldom involved in the day-to-day activities of the hotel, and often only play a ‘big brother’ role. Therefore, this leads to the inevitable discomfort among managers as to the maintenance of their brand standards. In order to safeguard the brand, managers have designed methods to monitor the brand and its representation by the owner. This finds expression in the franchise agreement through various provisions, including damages for failure to comply.

From the owner’s point of view, it is important for the owner to provide utmost importance to the maintenance of the franchisor’s brand standards as customers expect that a brand will offer a consistent experience. An owner that does not comply with the brand standards, will dilute the value of the brand, and ultimately the interest of both parties to the franchise agreement will be adversely affected.

Liquidated Damages

An increasing number of franchisors are including liquidated damages (“LDs”) provisions in their franchise agreements. Managers use the LD provision as a means to exercise control over, and compliance by owners.

In a liquidated damages clause, the owner and franchisor to a contract agree to pre-determined damages payable to the non-defaulting party in case of an early termination. In the context of a hotel management franchise agreement, the “non-defaulting party” is always the manager. There is never a reciprocal provision

that entitles the owner to liquidated damages. There is sometimes a concern amongst owners that franchisors may terminate the franchise agreement on subjective grounds and claim LDs.

Therefore, it is important for owners to carefully consider what events would allow LDs to managers. Owners should consider negotiating a *de minimis* and a *de maximus* amount of LDs as part of their LD provision. Further, consideration is to be given to factors causing the termination – whether the same was due to an act of the owner or the manager, or whether the same was a force majeure, whether the owner complied with its mitigation obligations, and so on.

Restrictions on Transfer of Interest

Hotel Franchise agreements are personal contracts for the benefit of the named owner only, and are further limited by the owner's ownership structure as of the effective date of the agreement. Therefore, it would logically proceed that the franchisor places considerable transfer restriction on the owner.

Often, the franchise agreement terminates with the change in ownership. But for those managers that permit transfer, franchise agreements are rigged with a complicated transfer provision coupled with tedious conditions for the prospective transferee, much like the HMAs. In some cases, the owner is required to pay a buy-out fee to the franchisor which increases the cost of acquisition for a third party, thereby limiting potential purchasers.

Frequently, franchise agreements also require the owner to seek franchisor approval in case of any invitations of private placement. The franchise agreement spells out considerable control by the franchisor over the process of private placement – the franchisor reserves the right to approve, amend or delete any provision describing the franchise agreement or of the relationship between owner and manager, or any use of the brand, contained in any offering memorandum or other communications or materials the owner proposes to use in the sale or offer of any securities.

Negotiation of this provision requires thoughtful deliberation between the parties so that the franchisor can identify issues perceived, and the owner can provide meaningful comfort to the franchisor.

Protected Areas

In any HMA, the provisions dealing with the restricted area almost always exclude any franchise operated hotel under the same brand. So also, the hotel brand seldom provides the franchisee with an area of exclusivity, that is to say, a geographic area within which he will not own, run, operate or franchise a hotel under the same brand. A very real possibility the owner could face, is another hotel of the same brand being run in its backyard with the potential consequence of reservations and other business being diverted.

Owners may however, consider that it would be imprudent for an operator to have more than one hotel under the same brand within a relatively small geographic area, but nonetheless actively seek an area of protection within which another hotel of the same brand will not be owned, run, managed, operated or franchised by the franchisor or its affiliate companies.

The franchisor and franchisee relationship is a complex one, and with the evolution of the model in India, we are sure to see some of the above issues cleared up, while possibly making room for new ones. Like any other agreement, both parties should weigh their options and determine which rights are meaningful for them to be able to maximize their performance under the contractual arrangement.

Employment Relationship under HMAs

“Train people well enough so they can leave, treat them well enough so they don't want to.”

~ Sir Richard Branson

Under the hospitality management arrangement, one of the functions of the manager is to recruit and train all employees of the hotel. Further, the manager is also responsible for setting the human resource policy in all respects, including the hours of work, remuneration package, days of leave, and so on. . The manager directs and controls the employees in the performance of their duties in relation to the hotel. Barring a few key personnel, the owner typically has little to no say in the recruitment, retention and human resource policy adopted and implemented by the manager.

The wide role of the manager in relation to the hotel employees would cause one to believe that employees of the hotel are employees of the manager. But, in reality, the hotel employees are engaged by the owner of the hotel. And therefore, the owner becomes responsible for the employees in the performance of their functions and duties in course of their employment. In light of this background, it becomes important for a owners to understand their responsibilities to the employees under law.

Master- Servant Relationship

We examine the relationship between the employee, the owner and the manager (if any) in terms of a master – servant relationship. This is necessary to understand the liability of the employer for acts committed by his/her employees. The terms “master” and “servant” are used to describe the legal relationship between the employer viz. the master and the employee viz. the servant, and is based on the control exercised by the employer over the services provided by the employee. Generally,²

- the master can tell the servant what to do;
- a servant is a person who not only receives instructions from his master but is subject to his master's right to control the manner in which he carries out those instructions;
- generally, a servant, qua servant, has no authority to make contracts on behalf of his master; and
- a servant is paid by wages or salary.

From the above, we observe that a master and servant relationship is determined based upon the amount of control the employer exercises over the service provided by the employee. Looking back on the relationship between the owner and employees, vis-à-vis the relationship between the manager and employee, it may be said that a master – servant relationship does not exist between the former, but does exist between the latter.

² *Lakshminarayan Ram Gopal and Son Ltd. v Govt of Hyderabad*, [AIR1954SC364] relying on Powell's Law of Agency

Vicarious Liability

As regards liability, a master will be liable for acts of an employee committed while within the scope of employment. Such liability attaching to an employer due to acts of an employee is called vicarious liability. As a general principle, a person is liable for the wrongful act committed by him/her. However, there may arise certain circumstance in which a person becomes liable for the wrongful act committed by others, even though he had no part or was not in fault in such wrongful act. The principle of 'vicarious liability' is determined by the legal maxim "*Qui Facit per Alium Facit Per Se*" meaning - the act done by me on behalf of you is not my act.

Vicarious liability in the law of tort³ may be defined as a liability imposed by the law upon a person as a result of (1) a tortious act or omission by another, (2) some relation between the wrongdoer and the defendant whom it is sought to make liable, and (3) some connection between the tortious act or omission and that relationship⁴. To prove vicarious liability under the law of tort, it is important to establish the relationship between the wrongdoer and the person who is sought to be made liable, that is, the master and servant. Generally, a servant is a person who not only receives instructions from his master but is subject to his master's right to control the manner in which he carries out those instructions, and has no authority to make contract on behalf of his master.⁵ There are various factors which are taken into consideration while establishing the master- servant relationship. For example, the extent of control of the master upon the servant, the kind of occupation, the place of works, the method of payment, and so on.⁶

Further, to determine whether a wrongful act committed is a vicarious one, it is also important to establish that the act committed was during the course of employment. This general principle is well settled in law. In case of *Sitaram Motilal Kalal Vs Santanuprasad Jaishankar Bhatt*⁷, the Supreme Court of India while referring to the law laid down in *Storey v. Ashton I.L.R*⁸ stated "*The true rule is that the master is only responsible so long as the servant can be said to be doing the act, in the doing of which he is guilty of negligence, in the course of his employment as servant.*"

In light of the foregoing, it remains to be tested under Indian law, whether, a manager could be held liable for the wrongful acts committed by hotel employees (who are not directly engaged by the manager, but by the owner). And in such a scenario, it becomes vital for the owner to seek appropriate indemnities from the operator, to protect against any liability to employees or third parties arising through mismanagement by the operator.

³ Law imposes a duty on every individual to respect the legal rights bestowed on others and any person interfering with someone else's enjoyment of their legal right is said to have committed a tort. Generally, tort is a breach of duty. In India, the law of torts is uncodified and is still in the process of development

⁴ Vicarious Responsibility in law of Torts, P.S Atiyah (London Butterworths, 1967)

⁵ Powell's Law of Agency, Page 20.

⁶ American re-statement of law Vol. IP 483

⁷ AIR 1966 SC 1697

⁸ (1868) Q.B. 476

Data Privacy Legislation in India and Ownership of Guest Data

"It used to be expensive to make things public and cheap to make them private. Now it's expensive to make things private and cheap to make them public."

~ Clay Shirky

In the highly competitive hospitality industry, every brand is trying to distinguish itself from the other. Even within a single hotel brand system, hotels are trying to carve out their own niche. A prime example is the W hotels, which operate a chain-run 'boutique' hotel, and each W resort places great importance on distinguishing itself from other hotels of the same brand. One of their tools to achieve this is to provide guests with personalised experiences. Details of guest preferences allow greater focus on personalised experiences for the guest. They are also key to more precise and targeted marketing and promotion programs. Each hotel management company collects information about its guests, often through its own loyalty program. Typically, this includes their name, age, residential address, birth date, contact information – telephone number and email address -- and in some cases, even includes their marital status, anniversary date, and income group. In addition to this, information such as room preferences, food and beverage tastes, and credit card information is also sometimes captured. Brands attempt to gather as much information as possible about their guests to enable them to provide tailor-made guest and hospitality experiences in an increasingly competitive hotel industry. This allows the particular brand to anticipate the needs of its guests, and also to develop concentrated marketing programs. Hotel owners are also interested in such data given that it is generated at their properties.

Guest data therefore assumes great significance, and owners and managers are acutely aware of the value attached to this information. Managers prefer to keep ownership of guest data to themselves, even to the exclusion of the owner. During the operating term, the data is shared between the manager and owner, however on termination; it is typical for the HMA to stipulate that the operator retains ownership of guest data. Other than ownership of data, the legal issues around data privacy are also gaining prominence. In several jurisdictions across the world, as well as in India, laws relating to privacy have been evolving. These could have some bearing upon the practices of managers and owners regarding collection of guest data and the protection thereof.

Ownership and Nature of Guest Data

As discussed above, the HMA's clearly specify that the ownership of guest data ultimately lies with the manager. This has led to clashes between owners and managers during HMA negotiations as the value of guest data has gained prominence through the years. These clashes are compounded by the fact that the data is collected by hotel employees who are typically employees of the owners, and such data is collected from guests at the hotel premises.

Other than this, the nature of the right to guest data may itself be a subject for debate. This is because the protection of such a right would be dependent on its nature. Indian courts have held that customer lists can constitute trade secrets and hence be protected in the same manner.⁹ However, customer data that is a part of the routine day-to-day affairs of the owner and is commonly known to others cannot be termed as trade secrets.¹⁰ Trade secrets do not have any statutory recognition of protection in India but have been recognized

⁹ *Burlington Home Shopping Pvt. Ltd v. Rajnish Chibber and Anr*, 61 1996 DLT 6

¹⁰ *American Express Bank Limited v. Priya Puri* 2006 Indlaw DEL 362

judicially as a common law right and is, as such, governed by the terms of the contract. However, equitable protection of trade secrets has also been recognized without the requirement of a contract in some cases.¹¹

Further, Indian courts have also recognized that customer databases can constitute literary works for the purpose of the Copyright Act, 1957¹² (“Copyright Act”) and accordingly be protected there under. Copyright would constitute a right *in rem* and would not be dependent on the terms of a contract.

If guest data is to be considered as works subject to copyright, the right to use such guest data would be subject to the Copyright Act, which prescribes requirements for assignment and licensing of works.

The manner of collection and compilation of the database, that is, whether manually or electronically, would also have a bearing as to who would be considered the author of the guest data. Questions also arise, as to whether moral rights, that is, the right to claim authorship and the right to restrain modification, are assignable under Indian law.

Data Privacy Laws

In India, there is no specific data privacy law in existence. The right to privacy has been recognized as a facet to the right to life under Article 21 of the Constitution. However, unlike in other countries there is no specific legislation dealing with data privacy although laws relating to information technology and telecommunications do include certain safeguards. There are currently two bills pending consideration in the upper house of the Indian Parliament, which deal with data privacy, processing and sharing, namely the **Right to Privacy of Personal Data Bill, 2016** and the **Personal Data Protection Bill, 2014**. Both these bills seek to protect personal data and require consent of the provider of information to enable any other person to process or share such data. The essence of what is considered as personal data entitled to protection under both these bills is data relating to individuals, which can lead to identification of such individual.

Where personal data is collected, processed or stored electronically, the provisions of the Information Technology Act, 2000 (the “IT Act”) and the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 (the “IT Rules”) would need to be referred to. Considering that all guest data is usually stored in the electronic form, the provisions of the IT Act and the IT Rules (collectively the “Indian IT Legislation”) would be applicable to the guest data collected.

The IT Rules deal with the conversion into, storage of, and passage of information or data in electronic form and reasonable security practices and procedures.

The IT Rules seek to protect both ‘personal data’ i.e. *“any information that relates to a natural person, which, either directly or indirectly, in combination with other information available or likely to be available with a body corporate, is capable of identifying such person”* and ‘sensitive personal data’ that is, certain specific information, which includes passwords, financial information such as Bank account or credit card or debit card or other payment instrument details, physical, physiological, and mental health condition, and medical information. Given that guest data would be capable of identifying individual guests and could include financial information, compliance with the IT Rules is a must.

¹¹ *John Richard Brady and Others v Chemical Process Equipments P. Limited and Another*, 1987 Indlaw DEL 10356

¹² *Vogueserv International Private Limited v Rajesh Gosain and others*, 2013 Indlaw DEL 3125

The IT Rules require that any person who on behalf of body corporate collects, receives, possesses, stores, deals with or otherwise handles information of provider of information, shall provide a privacy policy for handling of or dealing in personal information including sensitive personal data or information and ensure that the same are readily available for view by such providers of information who has provided such information under lawful contract. The privacy policy is required to contain certain information and be published on the websites of both the manager and the owner (as the owner's employees collect such information on behalf of the manager.) Further, the providers of such information are entitled to review the information provided, to enable them to correct or amend erroneous or deficient data. The practicality of this appears to be questionable.

Consent is required for the collection, storage, and disclosure of sensitive personal data. Where managers share guest data (which may include sensitive personal information) with their service providers and affiliates, specific consent from the guests for the onward sharing of data would be required.

The IT Rules require certain safeguards in case of transfer or transmission of the information as well as adoption and implementation of policies with respect to security practices and procedures by the collection agency. The collectors of personal information are also required to establish a mechanism for redressal of grievances in compliance with the provisions of the IT Rules.

Non-compliance with Indian IT Legislation would lead to penalties.

Given the international nature of the hotel management business, where several international chains manage hotels in India, it would be remiss not to mention that the Indian IT Legislation seeks to have extraterritorial reach. The IT Act clearly provides that any contravention of the IT Act outside India would constitute an offence under the IT Act. Therefore, even persons outside India to whom the personal data is disclosed could be made liable under the IT Act.

Therefore, collection, sharing and processing of guest data is not an issue that ends with the determination of who owns the data, but consideration is also to be given to who is required to meet the legislative requirements in terms of collection, storage, sharing, and handling of such data. This becomes particularly important under a hotel management set up since the employees collecting the data are typically owner employees, and therefore the obligation of compliance with Indian legislative requirements, would fall on the owner, even where the guest data may be collected purely for the manager. It is then for owners to consider whether bearing risks associated with the collection, storage, maintenance, and protection of data is acceptable even though they may have no access to, or use of, such guest data.

Data Breaches

Another important matter to consider is the liability in relation to data breaches. Given the increased reliance on information technology and various high profile hacks and data breaches spanning industries and even governments and political parties worldwide, guest data could, or may even possibly already have been, a target for a data breach.

HMA's do not provide for liability in relation to data breaches. Given that all the IT systems that are used at hotels are part of the worldwide systems of hotel management companies, owners may look askance at having to bear liability for claims made by guests on breach of guest data. At the same time, hotel management companies would resist having to bear liability due to malevolent third party actors over which they may have no control.

Whether insurance can be an answer to this liability, pending resolution of contractual liabilities, could be explored.

Dispute resolution Clauses in HMAs

“An ounce of mediation is worth a pound of arbitration and a ton of litigation!”

~ Joseph Grynbaum

Whilst lawyers and advisors must try and anticipate the risks in an HMA and find means to mitigate them, there will come a time when a third party will need to adjudicate. As someone once said, *“We as lawyers need to act as the fence on the edge of a cliff, but sometimes we have to be the ambulance below it.”*

The standard approach in HMA's across various hotel operators is to have a two-pronged approach – (a) have disputes resolved either by arbitration; or (b) by determination by an expert in the hospitality sector. However, certain operator's do opt for resolution of all disputes by arbitration.

Arbitration being one of the preferred dispute resolution mechanisms, certain factors must be considered while drafting an arbitration clause in an HMA.

Institutional or Ad hoc Arbitration

An institutional arbitration is one which is conducted with the assistance of an arbitral institution, e.g., the Singapore International Arbitration Centre ("SIAC") or the International Chamber of Commerce ("ICC"). The arbitral institution usually sets the arbitrators' fees (this may be scaled according to the total amounts in dispute), facilitates the exchange and dissemination of pleadings, enforces procedural deadlines, and reviews the arbitral award.

An ad hoc arbitration is one which is administered by the arbitral tribunal itself. A three-member tribunal and/or sole arbitrator as the case may be, will be appointed directly by the parties. In case the parties do not mutually agree to the appointment of an arbitrator, the parties will have to seek the Court's assistance. Fees of the arbitrators and the procedure to be followed in the arbitration proceedings will both be determined by the arbitrators themselves.

In case of an HMA, designating an institution in the dispute resolution clause would probably be the most ideal scenario. Further, while designating the institution, it may be prudent to review the institutional rules. For instance, if there are multiple contracts out of the same subject matter, designating an institution which provides for consolidation of proceedings would be advisable in order to avoid multiple arbitration proceedings.

Method of Selection and Number of Arbitrators

Parties usually specify in the arbitration clause or arbitration agreement as the case may be, that there should be either one or three arbitrators (specifying an even number will only risk deadlock). If parties fail to specify the number of arbitrators, then the applicable arbitration law will usually determine the number of arbitrators and the default appointing authority.

The institutional rules (if agreed between the parties) may also provide for a default appointing authority (for example, the institution's Chairman) if the parties cannot agree on the appointment of the sole or third

arbitrator. If the parties wish to have a say in the appointment of arbitrators, the dispute resolution clause may be framed accordingly.

The advantages of appointing a sole arbitrator are costs and speed. However, a sole arbitrator may not have the legal and/or technical expertise to address all the issues in dispute. A three-member tribunal is most common in international arbitrations, particularly if the amounts in dispute are significant or the issues are diverse or complex. A three-member Tribunal allows the parties to appoint arbitrators of various legal and technical skills to hear the dispute. There is also a lower risk that a three-member Tribunal will arrive at a wrong decision. However, the cost of three arbitrators can be high and should be weighed against the amounts in dispute.

In an HMA, if the dispute resolution clause provides for institutional arbitration, generally an institute itself will provide for the number of arbitrators as per the quantum of the monetary claims.

Arbitration Rules

The parties should determine the arbitration rules which, in addition to the arbitration law of the seat of the arbitration, will govern the arbitration procedure. Parties that choose to have their arbitrations administered will usually adopt the arbitration rules of that institution. Some of the more common arbitration rules used by parties include the SIAC Rules, the ICC Rules and the UNCITRAL Rules.

Parties are also at liberty to have the disputes administered by an institute while applying a different set of rules.

Language of the Arbitration

Parties should specify the language of the arbitration, particularly if the parties and their respective witnesses speak different languages, or if the law of the country governing the arbitration specifies that in the absence of any agreement between the parties, the arbitration should be conducted in the national language of that country. Failure to specify the language of the arbitration may ultimately result in parties having to incur expensive and unnecessary costs for translating documents and witness evidence.

If the parties do designate an institution, that is, the ICC or the SIAC, in the dispute resolution clause, the institutional rules provide that the arbitral tribunal may determine the language of the arbitration proceedings in the absence of agreement between the parties.

Place of the arbitration

The 'place' or 'seat' of the arbitration determines the arbitration law governing the arbitration procedure. The 'place' or 'seat' should not be confused with 'venue'. The venue can be anywhere; it does not have legal significance. It is the 'seat' of arbitration that has important legal implications.

Parties should select a neutral place, and also one where the local courts will enforce the arbitration agreement and support the arbitral process. For example, Singapore is a popular choice for parties doing business in Asia because Singapore is neutral and has a well established legal system that observes the rule of law. Singapore courts also offer a high level of support for arbitration.

However, while it is always better to have the 'seat' in an arbitration-friendly jurisdiction, the subject matter of the HMA must also be taken into consideration.

For instance, if the hotel property is located in India with parties to the HMA situated in the USA and Singapore, it may be advisable to have the 'seat' in India. This is for the simple reason that it will be the courts of the 'seat' where the parties will go to seek interim measures until the time a tribunal is composed. Now if the 'seat' would be in a jurisdiction other than India and if the courts over there pass an interim measure protecting the hotel property, that order will have to be brought to India and then appropriate proceedings may have to be filed for the order to be enforced. Therefore, parties may also factor in the above while providing for the seat of arbitration.

Also, if the parties fail to determine the 'seat' of arbitration in the dispute resolution clause, the arbitral tribunal may determine the same in case of an institutional arbitration.

Enforcement and Annulment/Setting aside of Awards

An award in an international arbitration once delivered may be enforced in any of the countries which are parties to the New York Convention, 1958 ("NYC"). The award must also have been delivered in a country which is a party to the NYC¹³.

The 'seat' of arbitration is most important when it comes to annulment and/or setting aside of awards as the award has to be compliant with the law of 'seat' and it is this 'seat' where the annulment and/or setting aside proceedings will be filed. It is therefore advisable to have the 'seat' in an arbitration friendly jurisdiction.

By way of a comparison, an award delivered in an international commercial arbitration seated in Switzerland, can be challenged only once before the Swiss Federal Tribunal. If the same award is delivered in India seated arbitration, the challenge proceedings will have to be filed before the relevant High Court, after which the parties may further choose to test the decision of the High Court before the Supreme Court of India which perhaps would be a more time-consuming process.

Expert Determination in HMAs

It is not uncommon in an HMA to provide for expert determination in a dispute resolution clause. Given the technical nature of an HMA, it may be fruitful to have the disputes presented before an expert who knows more about the industry as opposed to a practicing lawyer and/or former judge.

However, much depends on how a dispute resolution clause is drafted and how the clause treats the issue of expert determination. While in some instances, an expert determination clause may precede the clause providing for arbitration, in certain others an expert determination may be the only mechanism to resolve disputes.

Tiered arbitration clauses, in which one set of arbitration proceedings may practically be appellate arbitration proceedings against the decisions of another arbitral tribunal, have been recognized in India in a recent judgment. The facts are in relation to a contract for sale of copper to be delivered to a certain port. The arbitration provisions were invoked, and accordingly, the dispute was referred to the Indian Council of Arbitration (the "ICA"). The arbitrator appointed by the ICA passed a nil award. Aggrieved with this award, the party invoking arbitration also invoked the second tier. The arbitral tribunal constituted as per the ICC Rules,

¹³For enforcing an international award in India, the country in which the award was delivered/made, must not only be a party to the NYC but must have also been notified as a territory to which NYC applies, in the official gazette of India

allowed the claims. An application was filed for execution of the award before the District Judge at Alipore, which was then transferred to the Calcutta High Court. The Single Judge of the Calcutta High Court allowed the execution application which was challenged by way of an appeal. The division bench of the Calcutta High Court held that 'successive arbitrations' are not impermissible in India and further held that the ICC award is not a foreign award within the meaning of Section 44 of the Arbitration and Conciliation Act, 1996 and therefore Section 34 would apply in the facts and circumstances of the case. Being dissatisfied with the judgment, the parties approached the Supreme Court. The apex court had held that since arbitration is essentially a party-driven mechanism, with parties having agreed upon the mechanism of dispute resolution, the courts or an arbitral tribunal must respect the same.

However, if the parties provide for an expert determination as the only mechanism to resolve disputes, parties must ensure that the procedure prescribed to have the disputes adjudicated before such expert must follow the due process under the law. This is because if the due process is not followed, the award and/or decision rendered by the expert may be susceptible to setting aside and/or annulment proceedings. It may therefore be prudent to provide for a mechanism where an expert may render the decision and/or award while presiding over the disputes with a lawyer so as to ensure compliance.

It would be ideal if arbitration is proposed after an expert determination because in that situation parties may have a preliminary idea about the maintainability of a claim. Parties could perhaps also work out a settlement before invoking arbitration proceedings on the basis of such expert determination. Having stated the same, the draftsman of a dispute resolution clause must ensure that this exercise is conducted in a definite timeline in order to avoid delays in adjudicating a dispute. Also, the parties could name the expert in the dispute resolution clause so as to avoid delays.

An HMA may or may not provide for an expert determination. However, greater importance must be given to drafting the dispute resolution which may or may not provide for an expert determination and/or arbitration. Appointing the best expert in an industry will certainly not aid in effective dispute resolution if the basic factors, as discussed above, have not been taken into consideration. Likewise, if an arbitration clause is worded without understanding the nature of the agreement and the intention of the parties, the procedure for dispute resolution may indeed cause more harm to a party than the very dispute itself.

HMAs, like most commercial agreements executed in India, has been inclined towards ad hoc arbitration for resolving disputes. This trend, however, has seen a change, may be for the better, in the recent past possibly because corporations and individuals realize that while an institutional arbitration could be a more expensive procedure, it is in most instances, less time-consuming, while allowing parties to have a say in the procedure too.

While there cannot be a perfect model clause for dispute resolution as the same may differ depending on the parties' intentions and the nature of the agreement, the following are the basic dispute resolution clauses under different arbitration rules which can certainly be developed upon:

	Standard Clause
ICC	<p><i>"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules."</i></p> <p>The parties may also wish to stipulate in the arbitration clause:</p> <ul style="list-style-type: none"> the law governing the contract; the number of arbitrators; the place of arbitration; and/or the language of the arbitration.
LCIA	<p><i>"Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause".</i></p> <p>The number of arbitrators shall be [one/three].</p> <p>The seat, or legal place, of arbitration shall be [City and/or Country].</p> <p>The language to be used in the arbitral proceedings shall be [].</p> <p>The governing law of the contract shall be the substantive law of [].</p>
SIAC Rules	<p><i>Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration administered by the Singapore International Arbitration Centre ("SIAC") in accordance with the Arbitration Rules of the Singapore International Arbitration Centre ("SIAC Rules") for the time being in force, which rules are deemed to be incorporated by reference in this clause.</i></p> <p>The seat of the arbitration shall be [].</p> <p>The Tribunal shall consist of [] arbitrator(s).</p> <p>The language of the arbitration shall be []</p> <p>APPLICABLE LAW</p> <p>Parties should also include an applicable law clause. The following is recommended:</p> <p>This contract is governed by the laws of []</p>
MCIA	<p><i>Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration in accordance with the Arbitration Rules of the Mumbai Centre for International Arbitration ("MCIA Rules"), which rules are deemed to be incorporated by reference in this clause.</i></p>

	<p>The seat of the arbitration shall be []</p> <p>The Tribunal shall consist of [one/three] arbitrator(s).</p> <p>The language of the arbitration shall be []</p> <p>The law governing this arbitration agreement shall be []</p> <p>The law governing the contract shall be []</p>
<p>HKIAC</p>	<p><i>"Any dispute, controversy, difference or claim arising out of or relating to this contract, including the existence, validity, interpretation, performance, breach or termination thereof or any dispute regarding non-contractual obligations arising out of or relating to it shall be referred to and finally resolved by arbitration administered by the Hong Kong International Arbitration Centre (HKIAC) under the HKIAC Administered Arbitration Rules in force when the Notice of Arbitration is submitted."</i></p> <p>The law of this arbitration clause shall be [] .</p> <p>The seat of arbitration shall be []</p> <p>The number of arbitrators shall be ... (one or three). The arbitration proceedings shall be conducted in []</p>
<p>UNCITRAL</p>	<p><i>Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force."</i></p> <p>The appointing authority shall be []</p> <p>The number of arbitrators shall be []</p> <p>The place of arbitration shall be []</p> <p>The language to be used in the arbitration proceedings []</p> <p>The law governing the proceedings will be []</p>

Will GST Show Some Hospitality to the Sector?

“Be wary of a strong drink. It can make you shoot at tax collectors..... and miss”

~ Robert A Heinlein

The hospitality business is growing widely with flagship hotels taking the franchisee route to expand their businesses. Considering the land and development cost, many hotel owners are inclined to expand their business via franchise model. In majority of cases in India under this model, the brand owner is situated outside India and the franchisee is situated in India.

Broadly as per the said model, the hotel owner ('brand owner') enters into the following key agreements with the franchisee:

- Technical Service Agreement – Agreement to provide technical advisory and consultancy services to the franchisee for development of the hotel as per the standards of the brand owner for a mutually agreed lump sum amount.
- Hotel Management Agreement – An agreement to provide hotel management services wherein the brand owner operates the hotel on behalf of the franchisee as per the hotel standards. The brand owner normally charges a percentage of revenue earned by the hotel as its fees for these services.
- License Agreement – Agreement giving the franchisee a license to use brand name, marks, logos in the hotel premises. Normally, a percentage based royalty is charged by the brand owner for the rights.

The broad level Indirect tax implications with respect to the above structure are discussed below.

Implications under the Existing Regime

Technical Service Agreement and Hotel Management Agreement, being pure service agreements are governed by the Service tax law (i.e. Finance Act, 1994 (as amended from time to time) and rules made thereunder). As per the current law, Service tax is leviable on services that are provided in India.

In order to determine whether a service is provided in India or otherwise, the Place of Provision of Service ("POPOS") Rules have been introduced. Depending on the nature of the services under the Technical Services Agreement, the POPOS could be location of the immovable property or the location of the recipient, whereas for services under the Hotel Management Agreement, the POPOS would be the location of the immovable property. In cases where the brand owner is located outside India, the services qualify as import and the liability to pay Service tax under reverse charge mechanism is in the hands of the recipient i.e. franchisee.

Under the License Agreement, the brand owner transfers the right to use the trademarks, service marks, brand name, etc. to the Franchisee. While Service tax is being discharged on such transactions, the levy of VAT on such transfers has been a matter of litigation wherein authorities have sought to levy VAT treating such transactions as deemed sale.

Proposed GST Regime

India is on the cusp of implementing its biggest Indirect tax reform by introduction of Goods and Services Tax ("GST"). The drafts of the model GST laws have already been released by the Government. It is likely that the GST may be implemented in India by July 01, 2017. It is therefore necessary to understand the implications of GST law on such arrangement.

Under GST, the taxable event is 'supply' of goods or services. Thus, under GST law, a supply of goods or services (as opposed to rendition of services or sale of goods under the existing regime) would attract GST.

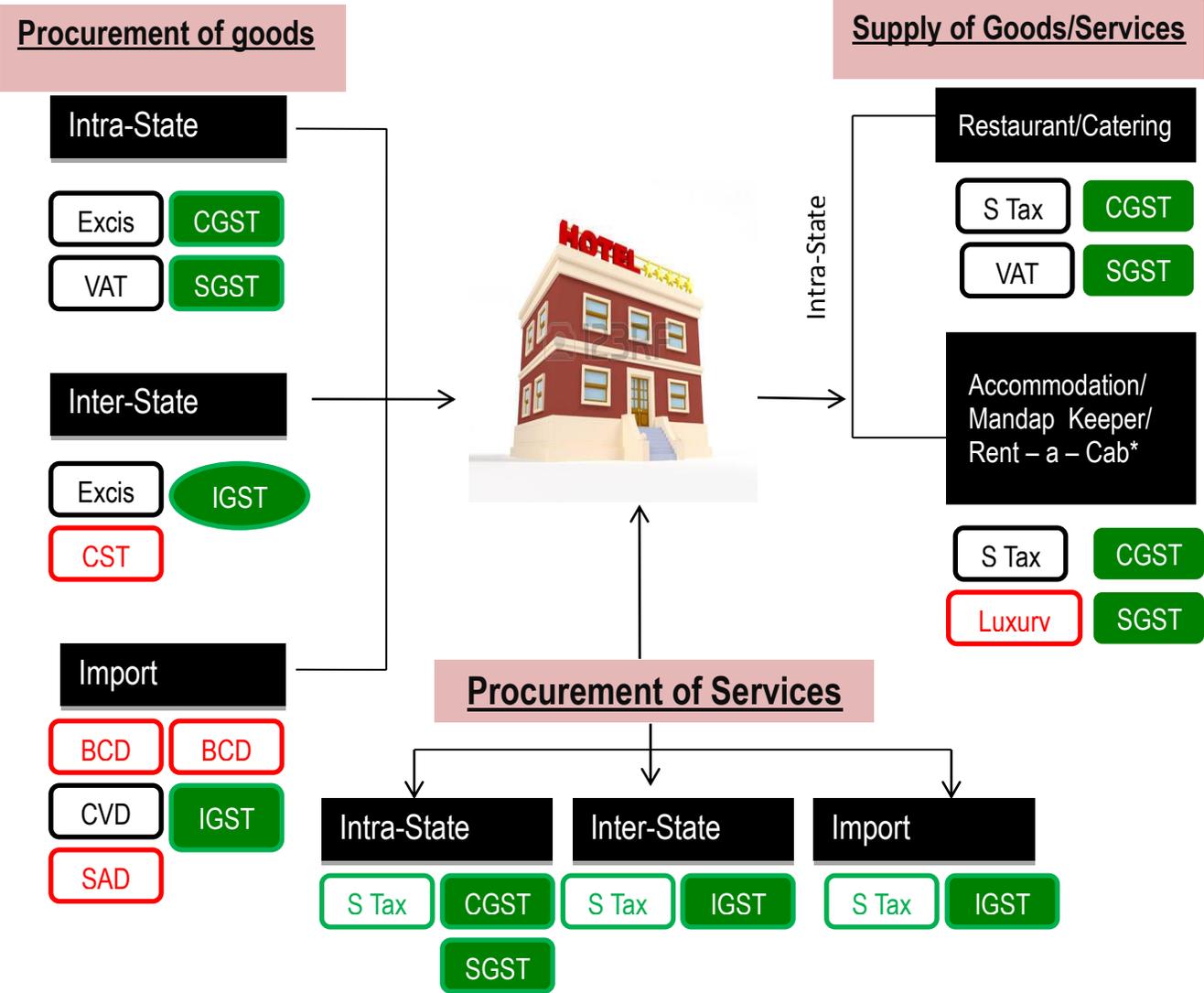
It is pertinent to note that Schedule II of the Model GST law gives the list of transactions which are deemed to be either supply of goods or supply of services. As per the said schedule, 'Transfer of Right to use' is deemed to be a 'Supply of Service'. Thus, under GST law, the contentious issue, as to whether a transfer of a right to use a trademark, brand name, etc. is a transaction in goods or services would no longer remain.

In view of the above, the brand owner shall be a supplier of service under GST. An intra-State supply of goods/services would attract a simultaneous levy of Central Goods and Services Tax ("CGST") and a State Goods and Services Tax ("SGST") whereas inter-State supply or import of goods and/or services would attract Integrated Goods and Services Tax ("IGST") which in terms of the rate would be a summation of CGST and SGST. A transaction would be intra-State where both, the location of the supplier and the place of supply would be within the same State and inter-State where both are in different states.

Based on the Model GST law, the place of supply in the current arrangement, could be decided based on the location of the immovable property and in some cases, possibly also the location of the recipient of the services.

Another important aspect of GST is that it would subsume a lot of existing indirect taxes including but not limited to Luxury Tax, VAT and Service tax. Additionally, a seamless credit of GST paid on procurements is likely to be permitted against the outward supplies.

The below given comparative diagram summarizes the broad tax impact for the hospitality sector under the GST regime:



- Non - Creditable
- Creditable
- Service tax and VAT levied at abated/composite rates, subject to credit restrictions

* If, under GST, any abatement is provided for rent-a-cab services, there may be input credit restrictions.

Note: As per the Model GST law; the above supplies would generally qualify as intra-State transactions.

In view of the above, it would be important to consider the potential GST implications when entering into such agreements with the objective of minimizing the indirect tax to either of the parties. Where possible, it may also be worth re-visiting the existing agreements for amendments and thereby optimising the tax costs.

Note on GATS

“Our grandfathers lived in a world of largely self-sufficient, inward-looking national economies but our great-grandfathers lived, as we do, in a world of large-scale international trade and investment, a world destroyed by nationalism.”

~ Paul Krugman

However it is the tourism and hospitality sector that connects people and cultures beyond boundaries to foster peace and growth.

Introduction

The General Agreement on Trade in Services (“GATS”) is the first multilateral, legally binding set of rules covering international trade in services. It came into effect in 1995 as a result of the Uruguay Round and is a part of the single institutional framework of the World Trade Organization (“WTO”). GATS establishes a framework of rules to ensure that services regulations are administered in a reasonable, objective and impartial manner and do not constitute unnecessary barriers to trade.¹⁴

The obligations contained in the GATS can be categorised into two broad groups: (i) General obligations, which apply directly and automatically to all Members and services sectors; and (ii) Commitments concerning market access and national treatment in specifically designated sectors that are laid down in individual country schedules. The GATS mandates WTO Member States to progressively liberalise trade in services through successive rounds of negotiations.

Services Covered

The agreement covers all internationally-traded services and defines four modes of supplying services:

- **Mode 1 - Cross-border supply:** This covers services flows from the territory of one Member into the territory of another Member (for example, banking or architectural services transmitted via telecommunications or mail);
- **Mode 2- Consumption abroad:** This refers to situations where a service consumer (for example, tourist or medical patient) moves into another Member's territory to obtain a service;
- **Mode 3 - Commercial presence:** This implies that a service supplier of one Member establishes a territorial presence, including through ownership or lease of premises, in another Member's territory to provide a service (for example, domestic subsidiaries of foreign insurance companies or hotel chains); and
- **Mode 4 - Presence of natural persons:** This consists of persons of one Member entering the territory of another Member to supply a service (for example, accountants, doctors or teachers). The Annex on Movement of Natural Persons specifies, however, that Members remain free to operate measures regarding citizenship, residence or access to the employment market on a permanent basis.¹⁵

¹⁴https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

¹⁵https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

The WTO currently has 164 Member Countries. Under the GATS, to structure the commitments of the Member Countries, a classification system comprising of 12 Core Service Sectors has been used. The sector services include Business Services (which includes Professional Services and Computer and Related Services), Communication Services, Construction and Related Engineering Services, Distribution Services, Educational Services, Environmental Services, Financial Services (including Banking and related services), Health-Related and Social Services, Tourism and Travel Related Services, Recreational, Cultural and Sporting Services, Transport Services and Others Services not Included Elsewhere.

Tourism and Hospitality Services

Tourism and Travel Related Services is one of the categories of the Services Sectoral Classification List¹⁶ and is divided into four sub-sectors:

- Hotels and restaurants (including catering);
- Travel agencies and tour operators services;
- Tourist guides services;
- Other

Current Status

As of 2009, tourism commitments have been made by over 133 WTO members, more than in any other services sector. Tourism services were also included in the on-going services negotiations which began in January 2000. Though services negotiations are part of the Doha Round under the GATS, not much has happened in these negotiations since 2001. However, these negotiations are relevant to tourism services. This is because the GATS definition of tourism leaves out many services activities including computer reservation systems, transport, hotel construction and car rentals, which have been regarded by the World Tourism Organization as key tourism-related industries.¹⁷

As a result of standstill in multilateral negotiations, India and several other countries have been negotiating Free Trade Agreements and Regional Trade Agreements. India has also entered into several bilateral trade agreements. Some notable examples which cover tourism and tourism-related services are: the India-Singapore Comprehensive Economic Cooperation Agreement, the India-Korea Comprehensive Economic Partnership Agreement, and the India-Japan Comprehensive Economic Partnership Agreement.

On 22 February 2017, the Trade Facilitation Agreement (“TFA”) on goods, entered into force, which aims at simplification and harmonisation of international trade procedures for goods. More recently, India also submitted a formal proposal for a TFA on services. India has proposed TFA in services specifically for liberalised visa regimes such as multiple entry visas, visa-free travel for foreign tourists and long-term visas for the business community, among other things. This will clearly impact the Tourism and Travel Related Services positively.

Besides this, 23 countries of the WTO are separately negotiating a Trade in Services Agreement (“TISA”) which aims at opening up markets and improving rules in areas such as licensing, financial services, telecommunications, e-commerce, maritime transport, and professionals moving abroad temporarily to provide services, and many areas that lie outside WTO's ambit. Therefore, it is likely that negotiations to facilitate opening up of trade in services under GATS are expected in the near future.

¹⁶ MTN.GNS/W/120

¹⁷ World Trade Organization, Background Note, S/C/W/51

The tourism and hospitality sector is among the top 10 sectors in India to attract the highest FDI. During the period April 2000-December 2016, the hotel and tourism sector attracted around US\$ 9.93 billion of FDI, according to the data released by Department of Industrial Policy and Promotion (“DIPP”). Moreover, India is expected to move up five spots to be ranked among the top five business travel markets globally by 2030.¹⁸

In light of the historical and expected growth in the tourism industry, which clearly impacts all the verticals of this sector such as hospitality and the like, the hospitality players (hotel brands and operators, PE Funds and Investors) collectively and individually would have to charter their requirements clearly for negotiations encompassing issues concerning investments, taxation issues, employment exchanges and other roadblocks which hamper the ease of doing business. It is therefore critical that the industry highlights the growing contribution of this sector to the GDP, social contribution skills by way of employment generation and promotes the business of other ancillary industries for the Government to consider this sector closely for future negotiations on services as it achieves all the social programs of the Government i.e. Make in India, Skill India and Digital India.

¹⁸<https://www.ibef.org/industry/tourism-hospitality-india.aspx>

Future Tense – Evolving Business Models in Hospitality

“If you want to make enemies, try to change something”

~ Woodrow Wilson

With the rapid development of information technology, where disruption is seen as the key *mantra*, many traditional business models have either grown dimmer or have been rendered almost obsolete. Online retailers and marketplaces have taken the place of brick and mortar stores, which are now trying to work in tandem with technology or trying to evolve new strategies to stay relevant. The likes of Uber have introduced asset-light models for businesses dependent on actual physical assets being available for service. In the hospitality space, a similar asset-light platform approach has been embraced by Airbnb and its imitators. Hotel room aggregation is another model which is increasingly common in India. Traditional hotel businesses are watching these new developments closely. The impact of these changes is as yet not completely known. Their influence is growing with the growing sophistication of technology and its reach, as well as demographic changes. However, as with any new innovations in technology and business, issues arise by reason of the regulatory framework. Often these models are evolved abroad and implemented in various countries, including India. Sometimes what works in one country from a regulatory standpoint may not work in another.

Understanding the Model

Platform Model

In this, property owners list their properties online on a platform accessible to travellers. The travellers are able to select properties based on pictures and information posted on the platform. Payments are made by the travellers to the property owners through the platform while the platform owning company is entitled to a commission. The platform owning company owns none of the properties. Instead its investments are in maintaining the platform online and through apps. The platform owning company also insures some of the properties. Both the property owners and the travellers write reviews of the guests, hosts and premises, thereby creating useful data relating to the credibility of both the hosts and the travellers.

Hotel Aggregators and/or Consolidators

Hotels aggregators and/or consolidators bundle together hotel rooms in unbranded hotels, provide training and customer service, and then provide a platform for reservation of hotel rooms by travellers. This model differs from the earlier model in some respects. Hotel aggregators only provide access to hotel rooms and not home stays. Further, additional services such as training and customer service are provided by hotel aggregators. There is a consolidation of hotel rooms that aims towards making distribution easier as well as the standardisation of pricing. This model also works on commissions. The actual hotel owners are permitted to separately sell their rooms as well.

Issues arising in New Models

Zoning Laws

Several cities have zoning laws that do not permit the use of premises in certain localities for anything other than residential use. Short-term renting of residential properties in lieu of hotel rooms, could, depending on local regulations be considered as commercial use and hence be violative of local zoning laws.

Property Taxes

The tax payable on residential properties is usually fairly lower than those payable in relation to commercial premises. In the platform model, where residential properties are listed for commercial use, the issue of payment of tax is murky. Further, in India, State Governments impose luxury taxes on hotels, lodging houses and resorts. Whether luxury taxes are payable on these kinds of arrangement may also be a question that could come up, pending the actual implementation of GST.

Licensing requirements

Residential hotels are required to comply with licensing requirements specific to each State, including under the local shops and establishments legislation. Typically, the term residential hotel is quite widely defined and may end up including residential premises that are let out through the platform model.¹⁹ Further, residential hotels are required to comply with certain norms under the local shops and establishment legislation in India. The laws do not currently recognize such an arrangement and more stringent norms may be applicable to such arrangements even though they maybe unwarranted. Serving food and alcohol within the premises, which could be considered as a commercial establishment, could also lead to the requirement of separate licenses.

Standards of Service

In both of the models discussed above, there is difficulty in maintaining standards of service at the hotels. Given that the business acts as an intermediary but has no control over the premises or the services, quality control becomes an issue. Even where standards are imposed contractually, given the nature of the business – where there are innumerable owners in innumerable locations, often far-flung – monitoring or enforcing such standards may be nigh impossible. Given the demanding nature of customers, quality issues create serious credibility issues that are difficult to address effectively.

Investment Restrictions

There is lack of clarity in the regulations applicable to online marketplaces and e-commerce businesses in India. Press Note 3 of 2016 (“**PN 3 of 2016**”) issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GoI, governs FDI in e-commerce retail and online marketplaces. PN 3 of 2016 prohibits FDI in the inventory based model of e-commerce which it defines as “*an e-commerce activity where the inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly*”. Whether a hotel aggregator could be said to have an inventory of services by reason of its arrangement with hotel owners is debatable, although it may not actually own the premises.

¹⁹ Under the Bombay Shops and Establishments Act, 1948, the term ‘residential hotel’ has been defined to mean “*any premises used for the reception of guests and travellers desirous of dwelling or sleeping therein and includes residential club*”.

Delays in Hotel Construction Projects

Hospitality in India is steadily growing, and with a burgeoning tourism industry, the direct contribution of travel and tourism to GDP is expected to grow at 7.2 per cent per annum, during 2015–25, with the contribution expected to reach USD 160.2 billion by 2026. While these figures may pale in comparison to figures for the US or China, this growth is a small step in the right direction. Hospitality growth that was earlier focused only on a few key cities and sites of importance from a historical and tourism perspective is undergoing a shift with many major operators actively looking to expand into tier II and tier III cities, depending on the population and market demand.

With a shift in focus to newer markets, newer projects are required to be developed. It is during this phase of construction that owners become acutely aware of delays that invariably plague a project. Certain delays or events that could lead to a delay may be mitigated or adequately dealt with under the HMA, but those that cannot be specifically dealt with, lead to a time and cost overrun.

Given that the construction of a hotel project often has many players involved, a focused effort towards co-ordination between the various consultants, engineers, designers and the operation is the need of the hour. Therefore, as soon as the technical or the design agreement has been inked, the owner's focus should shift to employing qualified and reputed consultants and designers. It is essential for the owner's design team to act quickly, so that plans and specifications can be readied and referred to the operator for approval. It is for them to use their skills and tools to ensure that hotels are built within the time schedule and budget. For this, a move away from pure penalties and liquidated damages is perhaps the need of the hour. A disciplined policy often yields better results. Designs done without extensive investigation of the site could contain potential errors, and such designs could lead to additional work, revision of scope of work, and contract revision as the actual site conditions begin to be seen during the construction phase of the project. How, then, is the owner to ensure that all the different players perform their functions effectively and efficiently? Contracts that create a partnership approach among contractors, owner, architects and suppliers are more likely to provide a better outcome than an adversarial approach, which has generally been the norm, so far.

Like any EPC contract, the owner must build in time lines within which the consultants are to provide their drawings, reports, findings, plans, and specifications. Joint efforts and coordination among the participants, and proper training of skilled manpower together with careful timing and scheduling of the project are a few solutions that can help to reduce such delays. With respect to the operator, definitive language is required to be built in to the HMA. This ensures that the operator is required to give its comments on the plans and specification provided within a certain period of time of receipt, failing which, the same should be deemed to be approved.

Another provision that Indian owners are building in to their agreements is that "*Time is of the essence*". This often finds expression in an HMA or the design services agreement through the project milestone schedule. The failure to adhere to the agreed timeline milestones are seen as a material breach of contract.

Another delay plaguing projects, especially in India, relates to obtaining governmental approvals. Further, the sheer number of approvals, permits, licenses, registrations, and so on, required from various authorities for a hotel project in India could in itself be a reason for delay – one is never sure of the exact number of approvals required to be obtained as state laws differ. Lack of valid approvals could lead to deferred opening of the hotel. Mitigating the cause of this delay is a bit more difficult when compared to delays relating to construction. One way could be to engage a local consultant to enumerate the approvals required and put a plan in place for application of the approvals as soon as practically possible.

Delays in construction and obtaining approval leads to a cost increase, which is ultimately borne by the owner. Hospitality projects typically have administrators, office workers, supervisors and other overhead costs such as insurance and equipment rental that keep accumulating as long as the construction phase continues. Therefore, delays lead to an invariable increase in overhead costs. From another perspective, any hospitality project involves some amount of debt financing and delays as mentioned earlier, (relating to approvals and construction milestones) and these also lead to an increased cost of financing the project on the whole.

Most HMAs provide an option the operators to walk away from the contract if the hotel is not open for business by a specified date. This is critical for the owner as he stands to lose. Even from the operator's perspective, it is a loss, because invariably the operator has agreed to forgo other opportunities in the vicinity once the HMA is signed. To get a hotel up and running by the agreed date is therefore in the interest of both parties. It is also in the interest of the lenders, as, if the funding is on a project finance basis, then the sooner the hotel starts to earn revenues, the more certain is the repayment of principal and interest.

A Broad Outline of the Process of a Hotel Construction Project

- Design
- Architecture
- Structure
- MEP
- Interior Design
- Landscape
- Facility
- Tenders & Procurements
- Work Execution
- Structure Works
- Masonry & Plaster Works
- Water Proofing Works
- External Plaster Works
- Façade Glazing Works
- External Painting Works
- External Development Works
- Facility
- Finishing works- BOH Area Ground Floor
- Finishing works- Public Area
- Finishing works- Guest Rooms
- MEP Equipment Delivery

- MEP Equipment Installation, Connection & Termination
- MEP Testing & System Commissioning
- Fire NOC Inspection Readiness
- Operator Snagging and Handover

Each of the above areas is where delays can, and often do occur. It would seem that coordinating time and activity management are the core skills required for such hotel projects, once the financing is up. With the family of players in the hospitality industries, it is the project managers who are the guardians of the trust that is reposed by hotel owners, operators and lenders.

Delays in construction projects can be prevented with adequate planning and preparation by all participants involved. A comprehensive solution to deal with the delays that plague construction contracts may be possible sometime in the future, and owners should carefully consider their options and seek appropriate advice from consultants to stem any issues that may arise as best as possible.

Insolvency and Bankruptcy Code, 2016

Background

After having gone through the stages of:

- (i) debt recovery under the Civil Procedure Code, 1908 or through debt recovery tribunals pursuant to the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (“**RDDB Act**”);
- (ii) enforcement under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“**SARFAESI**”);
- (iii) resolution with the Board for Industrial and Financial Reconstruction (“**BIFR**”) under the Sick Industrial Companies (Special Provisions) Act, 1985 (which now stands repealed); and
- (iv) restructuring through the schemes provided by the Reserve Bank of India, being the Corporate Debt Restructuring Scheme (“**CDR**”), Structured Debt Restructuring Scheme (“**SDR**”) or the Scheme for Sustainable Restructuring of Stressed Assets (“**S4A**”);

India continued to have a considerable amount of stressed assets and creditors continued to face challenges on recovery.

With an aim to address the issues faced by creditors in dealing with stressed assets, a Bankruptcy Law Reforms Committee (“**BLRC**”) was set up in August 2014 for providing a consolidated legal bankruptcy framework for India. The BLRC submitted its report and draft bill in November 2015. The Bill was introduced in the Lok Sabha in December 2015 and referred to a Joint Committee of Parliament. The Joint Committee of Parliament submitted its report in April 2016 and subsequently the Insolvency and Bankruptcy Code, 2016 (the “**Code**”) was passed by the Parliament on May 11, 2016 and published in the Official Gazette on May 28, 2016. Some of the key points of the Code included:

- A consolidated debt recovery and insolvency/bankruptcy regime for companies, individuals and partnerships/firms (other than for companies, the sections of the Code for other entities are yet to be notified);
- Inclusion of operational creditors in the insolvency regime;
- Framework for two stages - insolvency resolution, *i.e.*, revival of the company if possible and liquidation on failure to achieve such resolution;
- Strict timelines for expeditious recovery and adherence thereto, thereby preventing further losses to the creditors.

Issues Important to Stakeholders in the Hospitality Sector

On analysis of the Code and based on recent orders passed by the tribunals (whether the National Company Law Tribunal (“**NCLT**”) or the National Company Law Appellate Tribunal (“**NCLAT**”)), some of the points/issues that would be important for stakeholders in the hospitality sector are listed below:

- (i) **Interpretation of “Debt” under the Code:** The Code allows both operational creditors and financial creditors (in addition to the debtor company (“**Corporate Debtor**”) itself) to file applications for the corporate insolvency resolution process (“**CIRP**”) with the NCLT. For the hospitality sector, other than where financial debt has been provided, most cases would be where the relevant stakeholder would be an operational creditor. This would be the amount due in relation to goods supplied or services provided. It would be important to note that the CIRP is a financial creditor-driven process and the operational creditor has no right to vote in the committee of creditors, which takes the

relevant decisions for finalizing the resolution plan. However, the resolution plan has to identify the source from where the operational creditors are paid the 'liquidation value' within thirty days of approval of the plan, in priority to secured creditors.

Interestingly, various benches of NCLT have held that any amount that remains unpaid as a result of an issue surrounding 'deficiency of service' would not be considered to be 'debt' under the Code. For example, in case of renovation of a restaurant/ hotel premises, in case the contractor has not been fully paid on grounds of certain deficiencies in the service provided, such non-payment cannot be considered to be a default in pursuance to which a CIRP under the Code can be triggered. In fact the NCLT has gone ahead and suggested that the dispute over deficiency of service should first be settled before approaching the NCLT under the Code.²⁰ The NCLT has also held that "assured returns" cannot be considered to be 'debt' for which the Code may be triggered.²¹

Further, investors in the sector should take note that it is unclear whether default of payouts for redeemable preference shares and obligations under put/call arrangements would fall under 'financial debt' or 'operational debt' for which the Code may be triggered.

As per the definitions under the Code, an indemnity provided in pursuance to a financial transaction is covered under 'financial debt'. However, general contractual indemnities, which are not in pursuance to financial transactions, don't seem to be captured under definitions of 'financial debt' or 'operational debt'.

- (ii) **Interpretation of "Dispute" under the Code:** Under the Code, an operational creditor may not file an application for CIRP in case the corporate debtor responds to their notice with either evidence of an existing dispute or evidence of payment to the operational creditor. Though the definition of 'dispute' under section 5(6) of the Code uses the word "includes" and therefore suggests that it is a non-exhaustive definition, section 8(2)(a) requires the corporate debtor to provide a record of the pendency of the "*suit or arbitration proceedings filed*" before the receipt of the demand notice.

There have been conflicting judgments provided by the NCLT benches on the interpretation of "existence of a dispute". However, on May 24, 2017 in the case of *Kirusa Software Pvt. Ltd. v. Mobilox Innovations Pvt. Ltd.*, the NCLAT has held that the term "dispute" as defined in the Code is illustrative and not exhaustive. Such dispute must be relatable to the debt or default claimed. Therefore, the word "includes" ought to be read as "means and includes" including the proceedings initiated or pending before consumer court, tribunal, labour court or mediation, conciliation, and so on.

Accordingly, in case there are issues being faced with contractors and vendors, it would always be important to document and record the same.

- (iii) **Moratorium:** On admission of the application by NCLT, the tribunal shall order a moratorium period of 180 days from the date of the order. The section on moratorium also restricts the land owner to

²⁰ *Philips India Limited v. Goodwill Hospital and Research Centre Limited*– NCLT, Principal Bench, dated March 02, 2017; *One Coat Plaster v. Ambience Private Limited*; *Shivam Construction Company v. Ambience Private Limited* – NCLT, Principal Bench, dated March 01, 2017.

²¹ *Nikhil Mehta and Sons (HUF) and Ors v. AMR Infrastructures Limited* – NCLT, Principal Bench, dated January 23, 2017; and *Colonel Vinod Awasthy v. AMR Infrastructures Limited* NCLT, Principal Bench, dated February 20, 2017.

recover its property, which is in occupation or possession of the corporate debtor, during the moratorium period. The land owner does not have any rights under the resolution process, nor does it have a right to terminate the arrangement of tenancy/ lease/ leave and license or otherwise. It would therefore be important for land owners to incorporate mechanisms by which it is able to secure payments that may be due. One of the mechanisms that may be adopted is to ensure that the security deposit procured covers the period of moratorium.

- (iv) **Related Party:** To prevent misuse and potential value erosion, the Code has an expansive definition of 'related parties', wherein, in addition to the meaning understood under Companies Act, 2013, it *inter-alia* includes within its ambit, persons who are associated with the corporate debtor by: (i) participation in the policy-making processes of the corporate debtor, (ii) having two or more common directors, (iii) interchange of managerial personnel between the corporate debtor and such person, or (iv) provision of essential technical information to or from the corporate debtor. In case a 'related party' is a creditor, then the Code mentions that they will not be allowed to represent, participate or vote in the committee of creditors ("**CoC**"). Therefore, the stakeholders have to be very clear that they will not have any right to participate in the insolvency resolution process of any of their 'related parties'.
- I. The essence of effective implementation of the Code is adherence to timelines and procedure. The question of mandatory and directive nature of various timelines under the Code came up before the NCLAT, in an appeal filed by JK Jute Mills Company Limited.²² The NCLAT held that – *"time is the essence of the IBC and all the stakeholders, including the Adjudicating Authority, are required to perform its job within the time prescribed under the IBC except in exceptional circumstances if the National Company Law Tribunal, for one or other good reason, fails to do so"*.

There have also been cases wherein NCLT has imposed costs on corporates who had approached them with 'unclean hands' and had tried to take advantage of the moratorium for stalling other legal proceedings. The costs were imposed on the corporate debtor and its directors.²³

In light of the above issues and situations being faced by the advent of the Code, it is important that all stakeholders formulate procedures and modify their operations to ensure that they are ready to tackle situations under the Code. An important scenario is to be aware of whether any contracting party (from whom any amount is due) is undergoing a CIRP. There is no mandate to provide a notice to creditors at this stage. There will be a public notice released in newspapers, on the Corporate Debtor's website and on the website of the Insolvency and Bankruptcy Board of India. This public notice will also specify the date within which claims against the corporate debtor have to be submitted. Additionally, it will be important to have the stakeholders re-look at their agreements (whether hotel management contracts, other contracts with landowners, joint venture arrangements or vendor contracts) and address issues in pursuance to the Code. For example, it may be important to strengthen the information covenants to include information *qua* operational creditors specifically. The right of termination under contracts may be triggered by any application that may be filed against the counterparty for initiation of a CIRP.

The Code and implementation of the resolution plan will also give rise to structures and mechanisms by which prospective investors may get access to stressed businesses or assets and will therefore help in introducing additional cash flow in the system.

²² *JK Jute Mills Company Limited v. Surendra Trading Company* NCLAT, dated May 01, 2017.

²³ *Unigreen Global Pvt Ltd* NCLT, Principal Bench, dated May 08, 2017.

Though it is a well thought out legislation and intended to address the issues of creditors, implementation thereof is sure to keep contracting parties on their toes.

Did You Know?

1. Tallest hotels in a city

6 out of the top 10 tallest hotel in the world exist in one city - Dubai. It has over half of the top 10 tallest hotels in the world.

JW Marriott Marquis Dubai is the world's tallest hotel having 76 stories. This twin tower standing tall in Dubai, United Arab Emirates is 355 metres tall.

2. Total number of hotel rooms in the world

Total number of rooms worldwide is expected to be around 15.5 million as per the Intercontinental hotels group report.

3. City with the Highest Average room Rate

Many would believe that New York City; the city so nice, they named it twice, would take the trophy for this one. However, the city that has the highest average rate is Geneva, Switzerland. A room can cost almost \$308 on average per night. Phew!

4. Most expensive Hotel room

The royal Penthouse suite of Hotel President Wilson in Geneva is considered to be the most expensive hotel room in the world. Average price per night for this room is a whopping \$61,000- \$84,000 (approx).

5. Most visited country

France is the most visited country in the world - It attracts more than 80 million visitors annually.

6. Priciest Rooms in the US

The Ritz-Carlton Central Park and Mandarin Oriental tie places for the priciest room in the US. The room rates begin from \$995 per night.

7. Oldest Hotel in the world

Koshu Nishiyama Onsen Keiunkan in Japan is named as the oldest hotel in the world and is recorded in the Guinness Book of world records. The hotel is over 1300 years old. The ownership is held by the same family from over 50 generations.

8. Origin Spas

Another interesting hospitality industry fact is that thermal baths that led to origin of spa was introduced by Greeks in around 40 BC.

9. Cruise Ship numbers and destination

There are approximately 300 Cruise ships sailing which can accommodate over 300,000 guests daily. More and more hospitality professionals are finding the Cruise ship job options interesting and satisfying.

Caribbean has been the most popular Cruise destination over the years.

10. Most interesting Cruise ship

'The World' is one of the most interesting cruise ship. The travellers are permanent residents and the ship is on a voyage since 2002.

11. Hotel Managing as career option

There is a reason behind why hotel managing is becoming a favourable career option. They are believed to earn a whopping \$57,250 approximately on an average.

12. Men and Women ratio in hospitality industry

This is one of the key facts about the hospitality industry. You would be surprised to know that the hospitality industry has more women working for them than men.

13. Business or Pleasure

Statistics show that as compared to business trips, there are more rooms booked for the purpose of travelling and vacationing. This is not surprising though – who wouldn't prefer to vacation?

14. The World's Largest Hotel

Malaysia takes the cake for hosting the largest hotel in the world. First world hotel Malaysia is said to have around 7,351 rooms. The rooms are priced between \$12 to \$83 on average.

As an update to this hospitality industry fact, the largest hotel tag would soon be taken away from this Malaysian hotel.

Abraj Kudai Hotel in Saudi Arabia scheduled to open 2018 is expected to have around 10,000 rooms and over 70 restaurants.

Amazing, isn't it?

15. Costliest Room Service

The most costly room service is found in Las Vegas. You should be prepared to pay a tab of worth \$68 if you ever plan to stay in a hotel there. Las Vegas is closely followed by New York City in this matter. The average tab in NYC is about \$67.

*Source: <https://soegjobs.com/2016/07/12/16-astonishing-facts-hospitality-industry/>

16. Third Largest Foreign Exchange Earner

The Hospitality industry is the third-largest foreign exchange earner, accounting for 6.23% of India's GDP and 8.78% of India's total employment, according to a report by the Planning Commission.

17. USD 32.7 billion business in India

Travel and tourism is a USD 32.7 billion business in India, according to industry estimates; in addition, the hospitality sector is sized at USD 23 billion and is expected to grow to US\$ 36 billion by 2018.

18. The contribution of Travel & Tourism to GDP is forecast to rise by 4.9 per cent by 2021

According to the Tourism Satellite Accounting (TSA) research, released by World Travel and Tourism Council (WTTC) and its strategic partner Oxford Economics in 2011, the total contribution of Travel & Tourism to GDP, including its wider economic impacts, is forecast to rise by 8.8 per cent pa from INR 3,680.4 billion (US\$ 83.0 billion) (4.5 per cent of GDP) in 2011 to INR 8,523.1 billion (US\$ 191.2 billion*) (4.9 per cent) by 2021.

*Source: <http://www.hospitalityindia.com/hospitality-industry-in-india.htm>

Abbreviations

Term	Meaning
CCI	Competition Commission of India
CGST	Central Goods and Services Tax
Copyright Act	Copyright Act, 1957
Companies Act	Companies Act, 2013 (to the extent certain sections have not yet been notified and gazetted by the relevant Government Authority) and/ or the Companies Act, 1956, as amended from time to time
Competition Act	Competition Act, 2002
DCCO	Date of Commencement of Commercial Operations
ECB	External Commercial Borrowings (Foreign Currency Loans)
ECB Regulations	Master Directions of ECB issued by RBI
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FIIIs	Foreign Institutional Investors
FPIs	Foreign Portfolio Investors
FSI	Floor Space Index
GATS	General Agreement on Trade in Services
GoI	Government of India
GST	Goods and Services Tax
HKIAC Rules	Hong Kong International Arbitration Centre Rules
HMA's	Hotel Management Agreements
ICC	International Chamber of Commerce
ICC Rules	International Chamber of Commerce Rules
InvITs	Infrastructure Investment Trusts
InvITs Regulation	Infrastructure Investment Trust Regulations, 2014
Indian IT Legislation	IT Act and IT Rules
ICA	Indian Council of Arbitration
IT Act	Information Technology Act, 2002
IGST	Integrated Goods and Services Tax
IT Rules	Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011
LCIA Rules	London Court of International Arbitration Rules
MCIA Rules	Mumbai Centre of International Arbitration Rules
NDA	Non-Disturbance Agreement (Non – Disturbance Deed)
NPAs	Non- Performing Assets (Bad Debts)

NYC	New York Convention, 1958
PIS	Portfolio Investment Scheme
PN 3 of 2016	Press Note 3 of 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, governs FDI in e-commerce retail and online marketplaces
POPOS	Place of Provision of Service
RBI	Reserve Bank of India
REITs	Real Estate Investment Trust
REITs Regulations	Real Estate Investment Trust Regulations, 2014
SEBI	Securities and Exchange Board of India
SEBI Takeover Regulations	Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011
SIAC	Singapore International Arbitration Centre
SIAC Rules	Singapore International Arbitration Centre Rules
SPV	Special Purpose Vehicle
SGST	State Goods and Services Tax
TFA	Trade Facilitation Agreement
TISA	Trade in Services Agreement
UNCITRAL	United Nations Commission on International Trade Law
VAT	Value Added Tax
WTO	World Trade Organization

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