

firstresort: When in Doubt, Ask the Experts

Abhijit "Beej" Das, Kenneth E. MacKenzie and Harold Stahler

In separate recent discussions with members of the Goulston & Storrs Hospitality and Recreation Group, Rachel J. Roginsky, a principal with the national hospitality consulting firm Pinnacle Advisory Group and a frequent guest lecturer at The School of Hotel Administration at Cornell University and hotelier and G&S client Robin Brown, who served as General Manager of the Four Seasons Hotel – Boston for 14 years and is now a partner in the highly publicized Mandarin Oriental Boston project, spoke about the hotel industry's performance, current trends in hospitality, and a wide variety of issues that will affect the industry over the next several years.

Industry Trends

Roginsky: The number of hotel transactions and the price people are paying for assets today are two significant aspects of what is happening in the industry. Prices are very high – if somebody

wants to buy an asset, the chances are that the next guy wants it too, and will pay a bit more. I believe that hotel sales will continue at this pace for another year or so.

Brown: Two important trends are energizing the hotel industry. The amount of private equity that is chasing and available to chase hotel deals is surging, making hotels "in" again for investments. There was a scare a while back due to teleconferencing and the new technologies, that people wouldn't travel any more to attend meetings away from where they lived and worked, but the globalization of travel is enormous and has helped ensure that doesn't happen. People still value the impact of face-to-face meetings and are willing to travel to make that happen.

Investment Parameters

Roginsky: Many deals are being done at between 70% and 80% leverage with return

expectations of between 10% and 12%. Because of the overall size of these deals, buyers are bringing significant cash to the table.

Development Pipeline

Roginsky: We are just beginning to see the new supply materialize and based on our active feasibility study practice, there is a lot in the pipeline. More significant increases in supply should hit the industry beginning in 2008 and this will likely have a negative impact on room rates if the demand moderates.

Condo Hotels - Permanent Part of the Landscape or Fad?

Roginsky: Both. The condo hotel trend is a permanent and dangerous phenomenon. What we ask our clients is whether their project first works as a hotel? Can you make this work as an income producing hotel? If you can't, be aware of the danger because some of the buyers may well be buying a unit

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Managing the Graceful Exit

Business is good. Your investors are pushing for growth. Landlords promise prime locations and substantial construction allowances. It's a go for your national rollout. Now take a deep breath and, just for a moment (I promise), think like a lawyer. Bad things can happen to well-run stores.

Events outside your control can undermine brilliant merchandising and marketing campaigns. Before the landlord delivers its form lease to you, make a deal that accounts for the unspeakable: an economic downturn, a drop in sales and the need for an early exit from a location with your finances and reputation intact.

Your ability to obtain assignment and sublease relief diminishes mightily if you elect to present your position after the lease has been forwarded to you or your lawyer. Do not accede to the landlord's request to leave that to the lawyers or to handle that in the lease. Get it in writing in a term sheet when the landlord is eager to please and before you have expended emotional and financial capital on planning for this particular location.

If the landlord insists on a mutual termination right, focus on the numbers. The landlord's number should be lower than the tenant's; otherwise, the tenant could lose a profitable

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based on the belief that it will operate as an investment – an investment with returns that may never materialize.

Mixed use Projects

Brown: I see the mixed use model taking off in a variety of ways. I think from where we sit, the combination of retail and condominiums all within a world class hotel makes for a very good development. It allows a world class hotel to broaden its community involvement and enriches the experience for both the residents of the city and the guests and residents of the hotel. In fact, I don't think you would see a hotel like the Mandarin Oriental Boston get built with the quality we are going to present to the City without the mixed use concept – in fact, it would physically not be possible.

Lifestyles and Branding

Roginsky: Lifestyle hotels aim to make the environments more comfortable and less like square rooms - much like your home. There is a potential danger in this trend, however; lifestyles themselves change – what is cool today may not be cool tomorrow. As for brands, the savvy hotel person can define what the different brands are, but many travelers can't; they just see a different logo. Branding remains important in urban and suburban markets which are predominantly driven by corporate (Monday through

Thursday) travelers. These corporate travelers want to earn their travel points. Leisure travelers, on the other hand, may spend more time "Googling" alternate travel sites and will find independent non-branded properties. But at the end of the day, the brand generally wins.

Brown: I think in this environment, brand matters most of the time. We live in a very brand conscious culture. Going it alone is tough. Certain brands have done very interesting things to differentiate themselves. Take what Barry Sternlicht at Starwood did with the bed. They took something that was in front of every hotelier for hundreds of years – a bed – and took it into another world by making the bed the focal point of the guest experience. Sternlicht brought attention to the basics and branded them. That said, choosing the right brand for the right time, the right product and the right setting is very important. In our case, two branding identities produced positive results. Firstly, the experience, depth and credibility of the partners made it possible to get the type of clients who have signed on for residences and are anticipating our opening; and secondly, the Mandarin Oriental brand, with its reputation for service excellence, world class dining and phenomenal spa experiences provided the finishing touches.

Product Differentiators

Brown: In simple terms, a hotel is a clean

bed, sheets, a quick check in and checkout, easy parking and a good cup of coffee. So how does any hotel do enough to rise above the sea of \$99 rooms? It's all about the human touch, the personal aspect of it, that is. That separates the top of the pyramid from the bottom. There are several aspects to this, but three important ideas stick out: First, it is all about applying the Golden Rule – treating everyone – from the clients to the cleaning crew – with respect and dignity. The second is hiring: you can't train or teach the wrong person – they either have the gift at first, or they don't. As a general manager of a hotel, you know within less than five minutes in meeting someone and speaking with them whether they will fit and grow. The third is that there is no back office: in a great hotel, everybody is empowered to ensure total guest satisfaction and everybody, including the general manager, is not afraid to do whatever may be required – wash dishes, park cars, and so on.

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Managing the Graceful Exit

location. Think of it this way: if I don't reach the landlord's (lower) number, I will be so far below my target that I don't deserve to stay.

To further complicate matters, there are other areas of the typical lease which could stymie your exit strategy. For example, avoid at all cost the placement of your trade name in the use clause. If the use clause permits only the selling of specifically branded clothes, you have drastically limited your sublease/assignment flexibility. And watch out for signage restrictions. Your transferee is unlikely to sur-

vive with an outdated sign which poorly advertises a new venture. Finally, give yourself some room on alterations. It's likely that your transferee will want to redesign the premises.

A straightforward volume sales kick-out is a safety valve for a non-performing location.

Conclusion

If we've frightened you enough to pay attention to lease provisions you'd prefer

to ignore, we've accomplished our mission. The best strategy involves early intervention: put your best effort into the term sheet. Late stage negotiations after plans are complete and expectations are high will inevitably lead to compromises on critical points. And for a brief, concentrated moment, think of the lease as a prenuptial agreement: while hoping for the best, make room for the unlikely.

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Sales Tax on Shrink-Wrapped Software

Kenneth Y. Liu, John R. Grumbacher and Steven J. Snyder

Two recent Massachusetts tax law changes may provide new benefits and impose new burdens for licensors of shrink-wrapped software (also known as "standardized," "canned," or "prewritten" software). At the core of both changes is an equalization of the treatment given to shrink-wrapped software delivered on traditional media such as CDs and the treatment given to the same software delivered through Internet downloads, application service providers (ASPs) and "load and leave."

New Exemptions and Tax Credits

Effective as of January 1, 2006, Chapter 163 of the Acts of 2005 (the "Act") makes the development and sale of shrink-wrapped software, regardless of the method of delivery to the customer, a "manufacturing activity" under the Massachusetts tax laws. Before 2006, only delivery on a tangible medium qualified the software development as a manufacturing activity.

Corporations that engage in manufacturing may be entitled to a variety of tax exemptions and credits (e.g., a single sales factor to apportion income to Massachusetts, exemption from local property taxes on machinery, investment credit for certain expenditures). Some of these benefits require that the corporation apply to be classified as a "manufacturing corporation" by January 31 each year. The Massachusetts Department of Revenue (DOR) has not extended this filing date, so some of the benefits may prove unavailable for the current year.

More Expansive Sales Taxes on Shrink-Wrapped Software

In general, sales of tangible personal property in Massachusetts are subject to a 5% sales tax. Until recently, Massachusetts taxed sales of shrink-wrapped software *only* when the software was delivered on a tangible medium such as a CD. The tax was *not* applied to sales of the same software delivered through Internet downloads, ASP access or through an industry practice

known as "load and leave," in which the vendor traveled to the customer's location to install the software onto the customer's computers.

The favorable tax treatment for software delivered by "intangible" means ended on April 1, 2006. The Act amended the sales tax statute by providing that "[a] transfer of standardized computer software, including but not limited to electronic, telephonic, or similar transfer, shall also be considered a transfer of tangible personal property." In a recently issued Technical Information Release (TIR), the DOR stated that as a result of the new law, sales of shrink-wrapped software delivered by Internet downloads or "load and leave" would also be subject to the sales tax.

The DOR also explained that under the new law, "taxable transfers" of software would include "granting the right to use prewritten software installed on a remote server." This expansive definition of taxable transfers would affect ASPs which allow access to software installed on a remote server.

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Conclusion

Not all software products face this change in tax treatment. For example, data processing and electronic database services available by subscription remain exempt from the sales tax. Developers of customized software also remain exempt from the sales tax because such sales are treated as the delivery of professional services.

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We welcome the following attorneys to the firm:

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Abhijit "Beej" Das
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Suffolk Superior Court

Lena Goldberg
Exec. VP & General Counsel
Fidelity

Richard Zielinski
Goulston & Storrs



Moderator:
Thomas Sartory

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