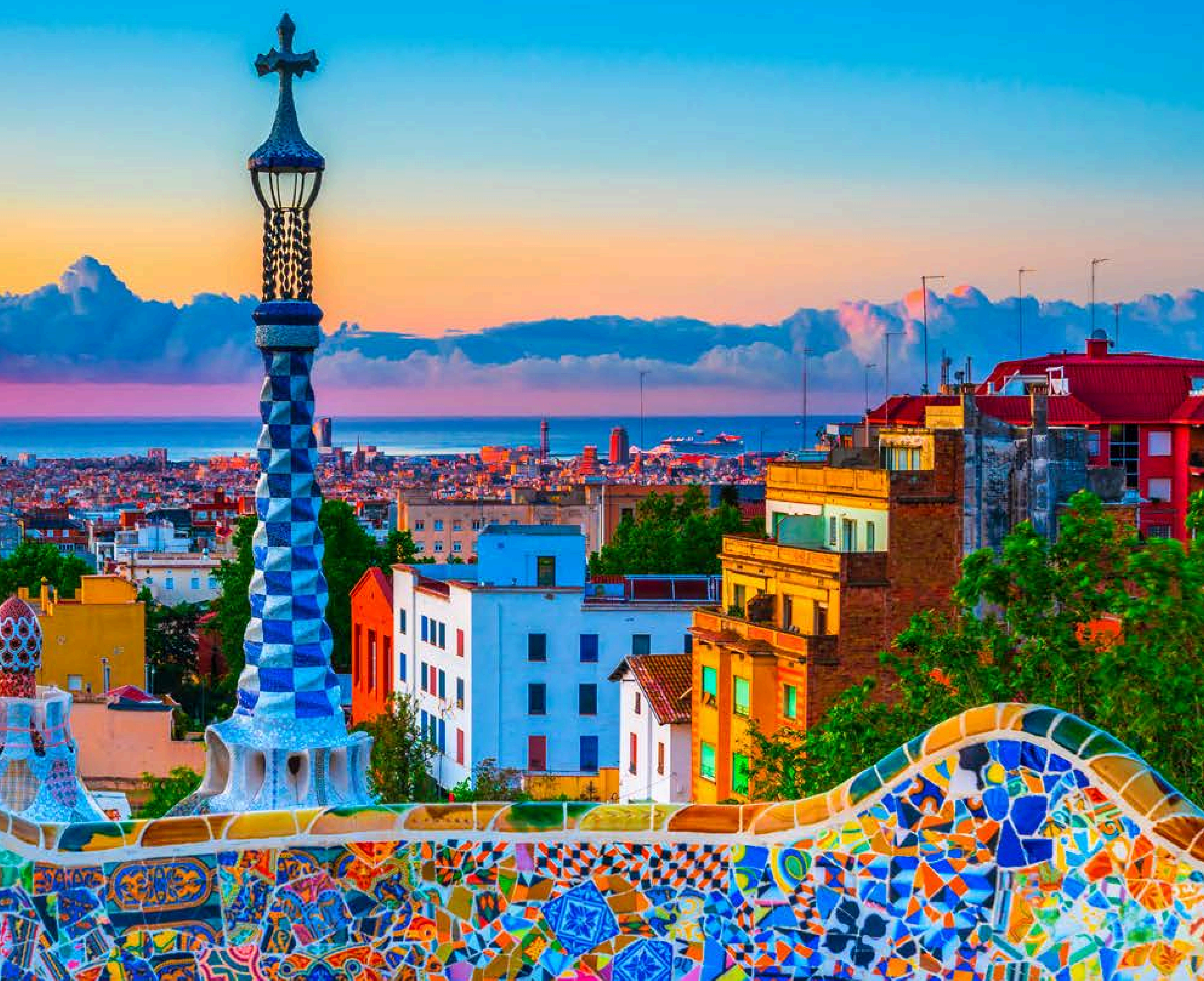
Hospitality Matters

Current topics in the hospitality industry

September 2024



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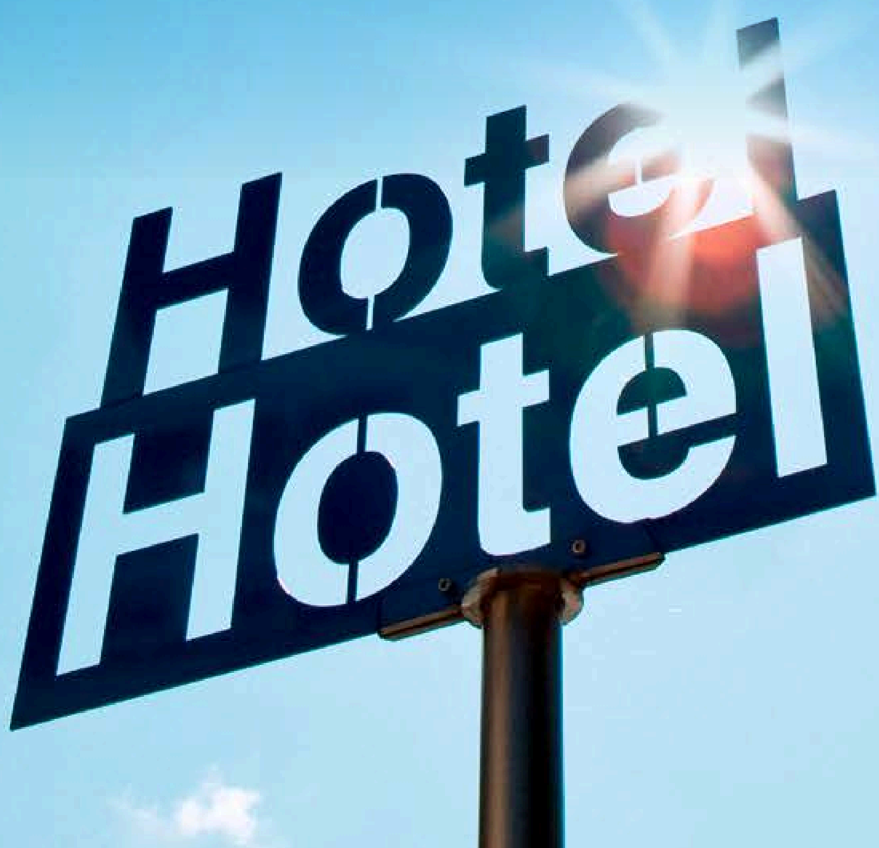

Welcome to Hospitality Matters

Welcome to our latest edition of Hospitality Matters. As I write this, we are all in "back-to-school" mode as we have just moved into September, the summer holidays are over and we start that busy period until Christmas where it seems that most of the deals are done every year.

The first half of 2024 has seen a few notable hotel portfolio and single asset transactions announced in the market and some in the press as ready to land fairly soon. We have also seen a great deal of activity between brands with Hyatt buying the Standard and Bunkhouse brands (having previously bought both Dreams and Mr & Mrs Smith in 2023) and Hilton buying both NoMad and Graduate brands. This activity, together with clear signs that interest rates are edging slowly lower, has given others confidence to launch sales processes. Together with an increasing amount of expiring debt that may be hard to refinance, we expect these factors to drive a continued increase in M&A activity in both assets and brands in the remainder of this year or spreading into the first part of 2025.

Our regional focus for this edition is the Iberian Peninsula. Spain and Portugal have been strong European markets for hotel transactions for the last three years and continue to attract international investors and development capital. Our Spanish team outline some of the recent trends and developments in the market there, that we have witnessed first-hand through the projects we have been involved in.

Finally, the hospitality industry has not traditionally been a highly regulated industry in the UK, but there have been a few recent developments spanning tips and service charges; a tourist tax in Scotland and "Martyn's Law", imposing new safety responsibilities on public hospitality and leisure premises after the tragic Manchester Arena bombing a few years ago. These are all highlighted in this edition.

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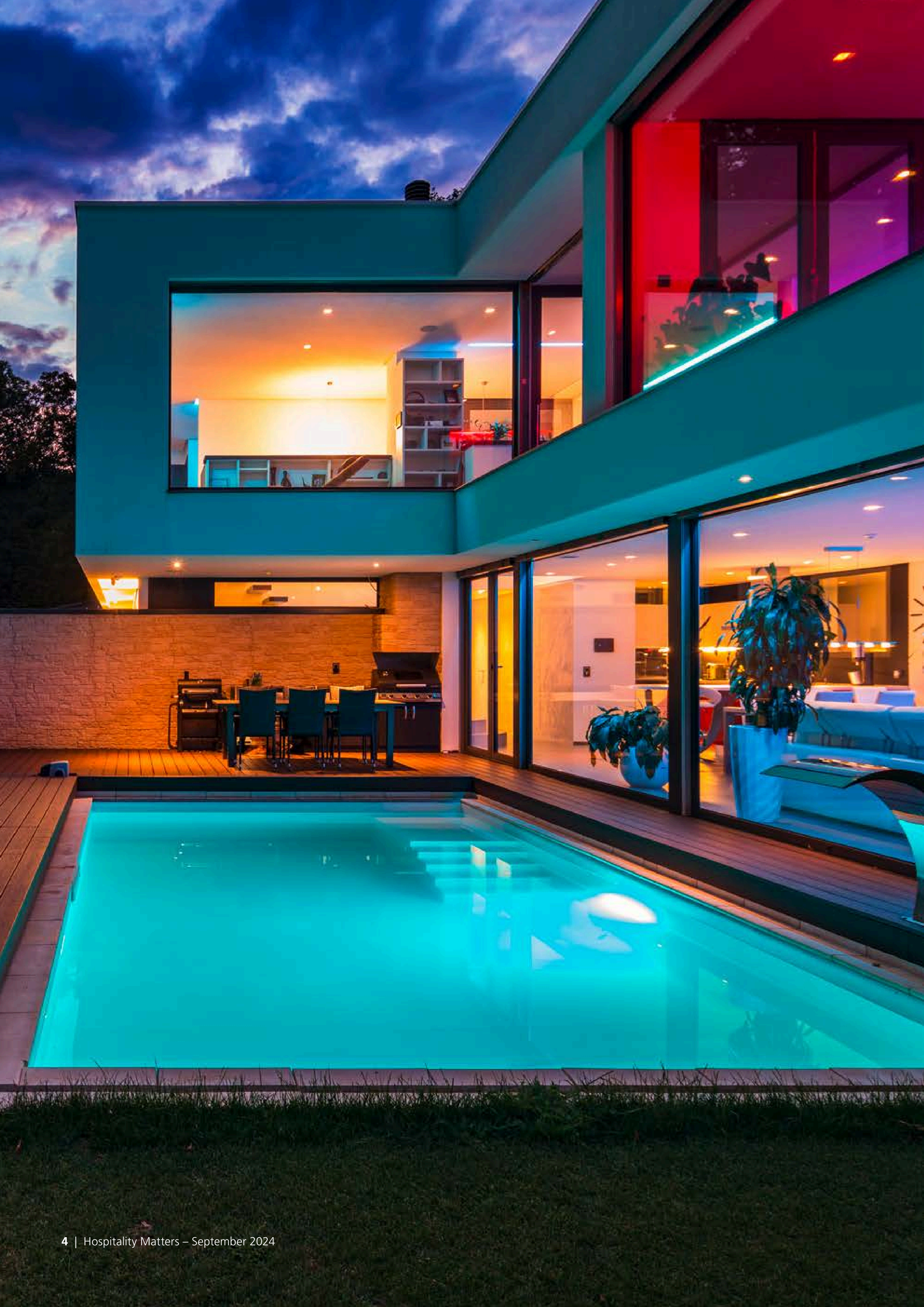

The evolution of hotel financial reporting

Unveiling the USALI 12th edition

The hospitality industry is on the cusp of a transformative era in financial and operational reporting with the release of the 12th edition of the Uniform System of Accounts for the Lodging Industry (USALI). This seminal publication, which sets the global standard for financial reporting within the lodging sector, has undergone a comprehensive revision. The latest edition introduces pivotal changes that hotel investors and operators must acquaint themselves with to stay ahead in a rapidly evolving marketplace.

A new chapter in sustainability reporting

One of the most significant enhancements in the USALI 12th edition is the introduction of non-financial sustainability-related reporting. The hotel industry is increasingly under scrutiny for its environmental impact, and stakeholders demand greater transparency in this domain. The new Energy, Water, and Waste (EWW) Schedule is a response to this call for accountability. It replaces the former Utilities Schedule and expands upon it with detailed accounts, descriptions, and metrics that facilitate improved monitoring and benchmarking of EWW cost and consumption.

The EWW Schedule is a strategic tool that aligns with the growing emphasis on Environmental, Social, and Governance (ESG) reporting requirements. It provides a framework for tracking greenhouse gas emissions and offers insights into the financial and environmental impact of a hotel's resource usage. By leveraging this schedule, hotels can evaluate the hotel's efficiency, reduce their environmental footprint and enhance their profitability while simultaneously preparing operators for information requests from owners and investors with a focus on sustainability, whether that is driven by strategic choices, lender requirements or increasing legislative obligations.

Enhanced transparency and benchmarking

The 12th edition of USALI heralds an era of enhanced transparency in financial reporting. New revenue and expense categories have been added, such as Guest Loyalty Program Costs and Executive Lounges, providing a granular view of operations. The inclusion of Full-Time Equivalents (FTE) in Schedule 15 allows for a consistent calculation of employee hours across departments, offering a clear measure of labour efficiency and productivity.

The new edition also addresses the unique reporting needs of all-inclusive hotels. This segment has seen significant growth, and the new guidance — termed AI1.0 — provides a format for equitable benchmarking and analysis for hotels where all-inclusive package revenue constitutes a majority of their total revenue.

Digital transformation in reporting

The digital transformation wave has not spared the USALI, with the 12th edition embracing technology to enhance accessibility and user engagement. The digital subscription service offers features for personalisation, such as the ability to annotate directly within the platform. Additionally, an online Revenue and Expense Dictionary has been introduced, allowing users to search via revenue and expense categories or by departments. Within the expenses categories, the new edition introduces new categories for Digital – Paid Search, Digital – Display; and Digital – Social to allow greater analysis of different types of digital marketing spend, to reflect the increasing proportion of total spend on digital channels.

Reporting of brand costs

The Annual Mandatory Brand and Operator Costs Schedule (16) captures all mandatory expenses related to brands and operators in one comprehensive table. It does not include additional optional services and pass-through costs. The Schedule delineates these costs into sub-categories such as Rooms, Sales and Marketing, Information and Technology, and Programs, Systems, and Services.

It is pivotal for investors as it consolidates costs that were previously scattered across multiple departments, thus providing a clearer picture of brand-related expenditures.

Why investors and operators should take note

The revisions in the USALI 12th edition are not merely incremental updates; they represent a strategic shift towards greater transparency, accountability, and efficiency in financial reporting. For investors, these changes mean access to more detailed information for making informed decisions about capital allocation and performance evaluation. Operators stand to benefit from standardised benchmarks that can drive operational improvements and competitive positioning.

In an industry where consumer preferences and regulatory landscapes are rapidly changing, adherence to the USALI's latest standards will be a hallmark of industry leaders. It signals a commitment to best practices in financial stewardship, operational excellence, and environmental responsibility.

As we embrace this new chapter in hotel financial reporting, it is clear that the USALI 12th edition is more than just a guide—it is an indispensable compass for navigating the complexities of modern hospitality finance. European hotel investors and operators who adopt these revised standards will undoubtedly be well-equipped to meet the challenges and opportunities that lie ahead in the dynamic world of lodging.

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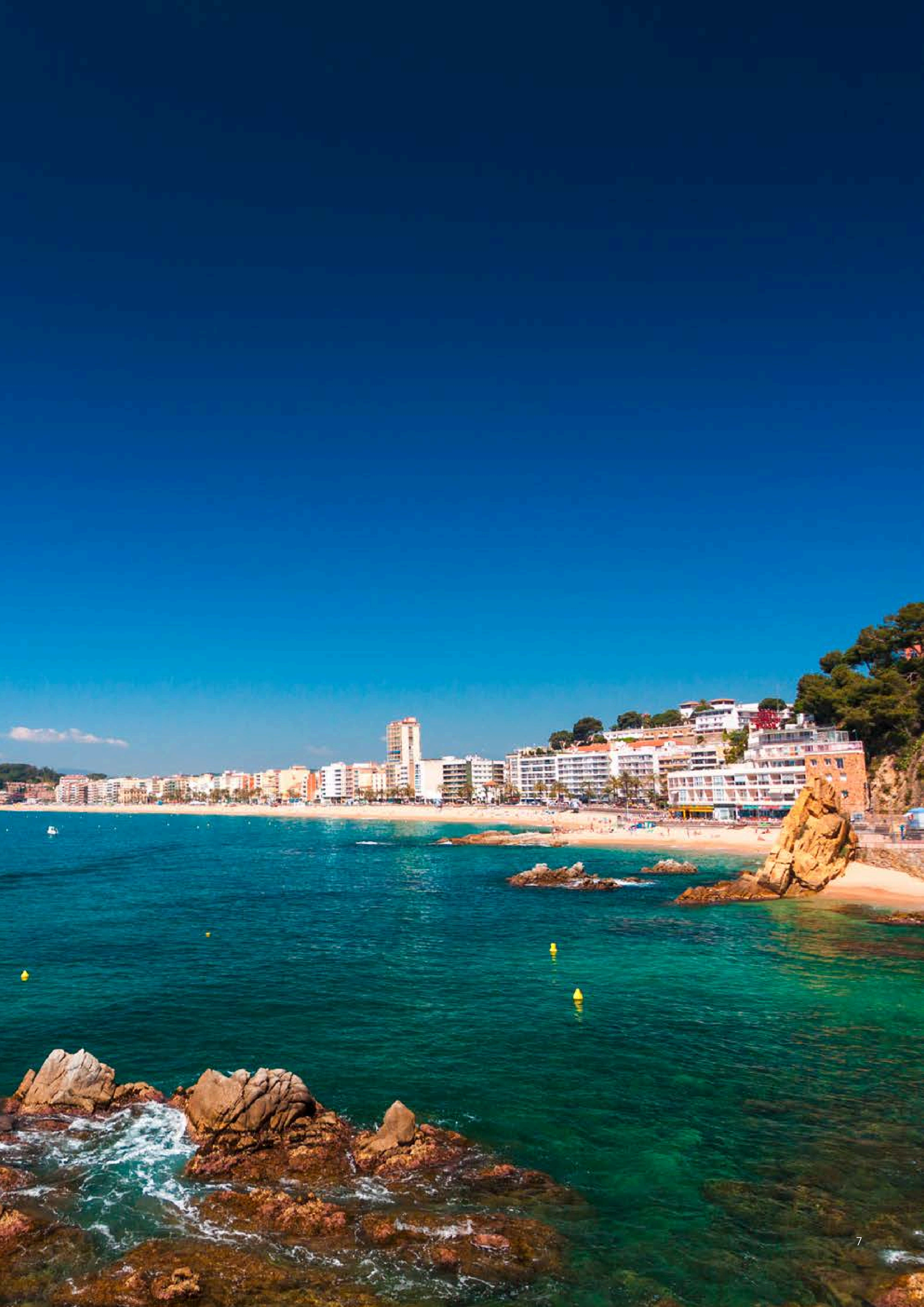


Regional focus

Resilience and growth: Analysing the hospitality industry in the Iberian Peninsula

Recent major developments

The Iberian Peninsula emerged as a beacon of resilience and growth within the hospitality sector in 2023. Spain captured a significant 30% of this investment, while Portugal secured 5%. The region not only led the EMEA region in hospitality investment inflows but also witnessed four of the largest hotel transactions in Europe as shown in the chart below.

Middle Eastern investments in Spain have notably increased from 3% a decade ago to 61% by the end of the year. While tourism statistics indicate a robust recovery in the region, with Spain's numbers not only returning to pre-pandemic levels but surpassing them with a 15% increase in hotel expenditures over 2019.

€180m	€200m	€250m	€600m	€650m
Hotel Sofia	**Mandarin Oriental Barcelona**	**Dom Pedro Portfolio**	**Equity Inmuebles Portfolio**	**Westin Paris Vendôme**
Hotel	Hotel	Portfolio	Portfolio	Hotel
Buyer AXA IM & Blasson Property Investments	**Buyer** Olayan Group	**Buyer** Arrow Global	**Buyer** ADIA	**Buyer** Dubai Holding
Vendor Brookfield AM	**Vendor** Farallon & Reig Captial Group	**Vendor** Dom Pedro Group	**Vendor** Equity Inmuebles	**Vendor** Henderson Park
Hotel c.465 rooms	**Hotel c.120 rooms**	**Portfolio 6 units**	**Portfolio 17 units**	**Hotel c.428 rooms**

Legal and investment trends

As the hospitality sector in the Iberian Peninsula continues to evolve, a series of emerging legal and investment trends are shaping its future. This section delves into some of the most significant trends currently transforming the industry.

Asset light strategies

A notable trend in Spain is that main hotel chains are adopting an asset-light strategy, focusing on management and franchising models rather than ownership. Over the last seven years, this strategy has increased by 6%, now accounting for 23% of the total Spanish hotel market. This period has seen notable growth in franchised rooms (39%) and in the management model (30%), accompanied by an increase in the presence of national and international brands.

Management and franchise agreements

Closely related to the trend mentioned above, is that the hospitality industry is increasingly leaning towards management and franchise agreements over traditional leases. These models offer economies of scale and potentially higher profitability but require careful legal crafting to meet the specific needs of all parties involved. Nevertheless, we expect traditional lease agreements to survive due to their flexibility and the protection they offer (through triple or double net clauses), to more conservative owners and lenders.

Innovative property developments

The region is also witnessing a transformative trend in the repurposing of assets, particularly in the conversion of office buildings into hotels. This shift is prevalent across Europe and presents unique legal challenges, especially in ensuring compliance with zoning and land-use regulations.

Simultaneously, the sector is adapting to the evolving preferences of diverse consumer groups, from Generation Z to Boomers. Mixed-use developments that integrate lodging, dining, and working spaces are becoming increasingly popular, catering to a growing demand for convenience and integrated lifestyle experiences. These developments reflect a shift in consumer behavior towards multifunctional environments that enable both work and leisure under one roof.

Secondary half-urban locations

The rise of secondary, "half-urban" locations such as Málaga (Andalucía) reflects a shift in consumer preferences towards destinations offering both leisure and remote work capabilities—a trend accommodated by adjusting zoning and land-use policies. These areas serve as refuges in winter and full-on leisure destinations in summer, offering interesting alternatives to traditional prime locations. In addition, this kind of destination are perfect for the mixed-uses people working in remote are looking for; a quiet place for work which has accessible leisure landscapes.

Hostels

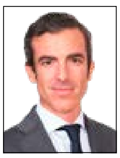
Hostels are one of the accommodation products that have evolved the most in the recent years. Lisbon is the second largest market by volume of beds (approximately 6,000) and the first city based on the number of hostels with more than 90 properties. The sector, initially focused on low-cost beds, now offers more traditional hotel products, such as double rooms and food & beverage facilities. This market segment, though still less developed than the hotel sector, is attracting institutional investors due to higher profitability than traditional hotel products, though product shortages persist.

Challenges and forecast

Full year projections for 2024 forecast another vibrant year, anticipating a 5-10% increase in property investments. Conservative investments (core and core plus) will lead this trend, while Midscale & Economy hotels will also appeal to lenders and buyers with lower leverage, particularly private equity firms and high-net-worth individuals who are predicted to be the main protagonists.

The main challenge in the hotel market is sourcing value-add supply in a crowded market where the best opportunities are usually already covered. New developments might be hindered by the regulatory zeal in some regions such as the Balearic Islands and Catalonia, although cities like Madrid remain attractive due to more stable regulatory conditions.

As the market continues to evolve, propelled by innovative investment and operational strategies, legal professionals will remain pivotal in steering its trajectory towards sustained growth and innovation.



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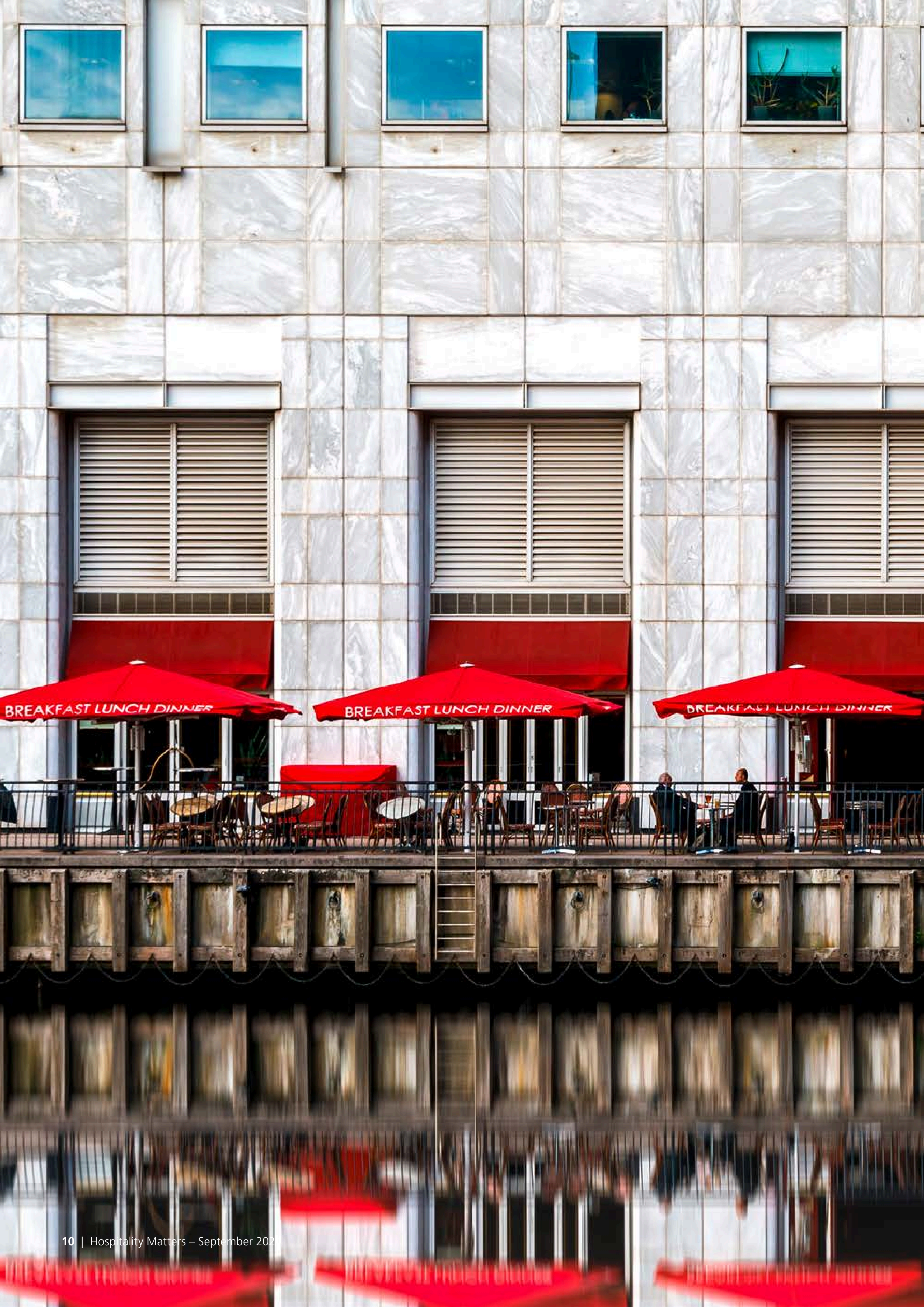

BREAKFAST LUNCH DINNER
BREAKFAST LUNCH DINNER

CMS European M&A Study 2024
Hotel & Leisure focus

In March 2024 CMS published the 16th edition of its European M&A Study; a report which analyses market trends and deal points from private M&A deals on which the firm advised in the preceding calendar year.

The 2024 edition reflects on 559 deals on which CMS advised in 2023 and marked a record for the number of transactions analysed for one year – a noteworthy outcome given the uncertain outlook for M&A flowing from sustained inflationary pressures, higher interest rates, slow growth and geopolitical tension. Of those deals, 36 were transacted within the Hotels & Leisure sector – itself a record number for the sector and emphasizing a resilient return to dealmaking following the depths of the pandemic.

In this article we take a look at some highlights from the M&A Study with a particular focus on the Hotels & Leisure statistics.

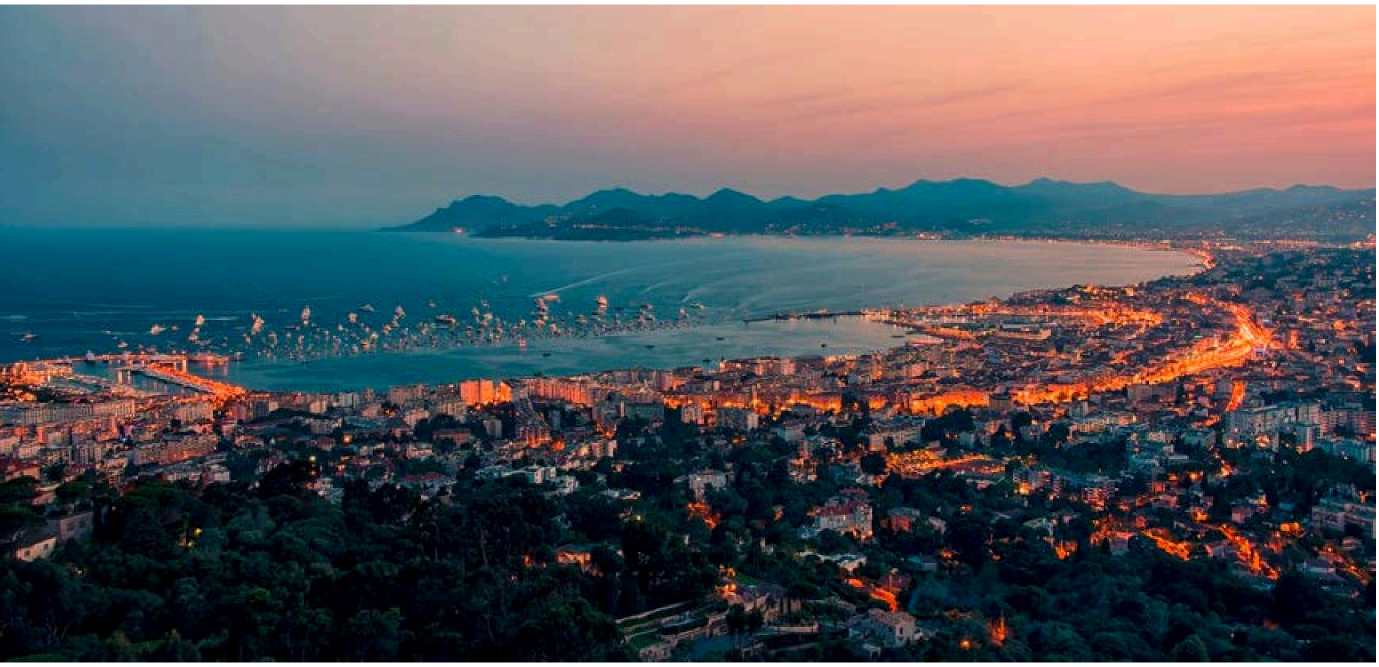
Strategic investors were more active in 2023, both as sellers (44%) and buyers (77%), than in 2022. At the same time Finance investors were less active buyers (17% of deals, down 5% on 2022 and the previous rolling average from the prior decade). There were fewer sales by individuals in 2023 (down 6% at 31%) but following the change of government in July 2024 and concerns as to potential changes to the capital gains tax regime anticipated in the forthcoming October budget, we are experiencing individual business owners/shareholders seeking speedily to conclude sale processes.

CMS has analysed the top deal drivers for undertaking M&A for the past 5 years. Entry into new markets, acquiring competitors and acqui-hire transactions have consistently been top of the rankings in this area when looking at all sectors albeit there is a wide variety of factors determining deal activity. Taking the Hotels & Leisure sector in isolation, acquisition of a competitor was stated as the main deal driver on 60% of deals, significantly higher than any other deal driver.

Despite the high focus in the media and legal and sector press, CMS' data continues indicates that ESG aspects have yet to become a fundamental component of M&A transactions. But in saying that CMS notes an increase in the number of deals involving specific ESG due diligence (up to 47% from 33% last year) whilst the amount of specific ESG provisions in the main transaction documents remains low (35%). The increase in ESG due diligence suggests that buyers, in particular investors, continue to carry out ESG investigations to uphold their own governance standards across industries and sectors. By contrast, the low number of deals with ESG provisions in the SPA suggests there is not yet enough confidence amongst buyers that sellers will accept the transfer of ESG risk onto them.

The use of Warranty & Indemnity (W&I) insurance in European Hotels & Leisure transactions remains popular on significant value deals – notably a W&I policy was purchased on 50% of deals having values between EUR25-100m and 67% on deals over EUR100m. This is consistent with statistics for other sectors where likewise the costs of purchasing the insurance is perhaps not seen as being merited on smaller value deals (only 4%). That said the W&I insurance market is increasingly competitive and new entrants to the market are attacking the lower value segment and so prices are currently attractive.

The data from 2023 demonstrates some changes in deal points relating to pricing in the sector – highlights are reductions in the number of deals involving purchase price adjustments/completion accounts and locked-box structures and a modest fall in earn-outs. This marks a reversal of the trends from the last two years where a fall-out from the pandemic had been a view that buyers



were concerned as to the reliability of the underlying financial performance of acquired businesses and would use price adjustment mechanisms and earn-outs to smooth over concerns over more volatile trading periods. The data for Hotel & Leisure deals demonstrates consistently a greater adoption of purchase price adjustments and few earn-outs.

Consistent with other sectors, more than half (52%) of Hotels & Leisure deals see sellers have a liability cap of less than 50% of the purchase price. For larger deals, a significant proportion, 33%, have a liability cap of less than 10% of the purchase price while for smaller deals this proportion is only 17%. By contrast small sized deals are more likely to have a liability cap equal to the purchase price or no liability cap at all, demonstrating a significant divergence across deal sizes.

This year's data from Hotels & Leisure transactions indicates a decrease of limitation periods longer than 24 months and an increase of limitations periods shorter than 12 months. These figures confirm the development towards a more seller-friendly market with regard to limitation periods.

In respect of seeking a form of security for warranty claims – the market remains seller-friendly. In only 22% of Hotels & Leisure deals were buyers able to demand a form of security for claims. This is likely due to the popularity of W&I insurance and the cost and time burden in obtaining escrow accounts or bank guarantees.

The use of material adverse change (MAC) clauses in Hotels & Leisure deals increased from 11% in 2022 to 14% in 2023. This is perhaps not surprising considering the economic environment with the geopolitical tensions in Ukraine and the Middle East, high inflation, and supply chain bottlenecks. Nevertheless, overall when looking at all deals in all sectors there has been a downward trend using MACs which could indicate that sellers are increasingly gaining the upper hand in negotiations. The disparity between Europe (10% overall) and the US (97%) regarding the use of MAC clauses is also significant.

CMS compares European and US market practice on various M&A deal points using data from US deals as presented by the SRS Acquiom Report. CMS reports that in the period during which it has published its European M&A Study, broadly speaking, the same differences in market practice between European and the US have always been noted. Key differences are purchase price adjustments on almost all US deals, MAC clauses on almost all US deals, lower % liability caps for sellers on US deals and a rapid growth in the W&I insurance market in the US in recent years.

In conclusion, CMS' European M&A Study 2024 underscores an optimistic outlook for M&A activity in Europe in 2024 and looking forward to 2025, highlighting resilience amid economic challenges. Key trends indicate a shift towards seller-friendly dynamics and robust deal flow, fuelled by improved market confidence and strategic entry into new markets.

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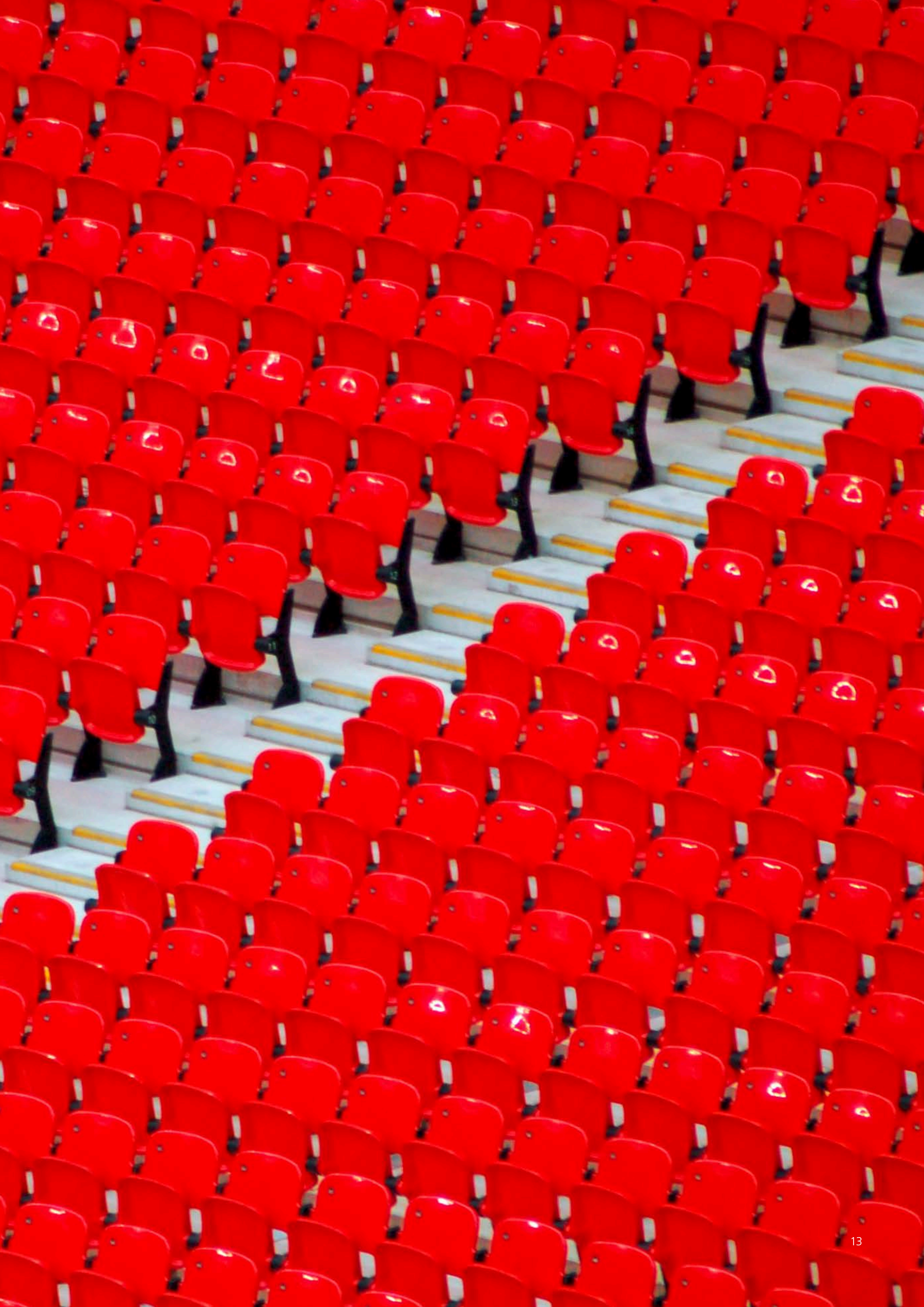


Martyn's Law

In May 2017, the Manchester Arena was subject to a terrorist attack which killed 22 people and injured 1,017 others. Martyn Hett, who was 29 at the time, was amongst those killed. Since 2017, there have been a further 14 terror attacks in the UK.

In response to this complex, evolving and enduring threat, the previous Government developed the Terrorism (Protection of Premises) Bill, also known as 'Martyn's law', which was expected to become legislation as part of the 2023-2024 parliamentary session. There was then some uncertainty as to if and when the new Government would still seek to enact Martyn's law, and if that would remain in the form of the proposed bill. It was however included within the King's Speech on 17 July 2024 and so it appears that this new law is well and truly on this Government's agenda although the timing of its coming into force remains as yet unknown.

The Premise of Martyn's Law

If the Bill is enacted in its current form, a new 'protect duty' will be imposed on the operators of public venues and events across the UK, which is intended to mitigate the impact of a terrorist attack and reduce harm.

The implementation of Martyn's Law will be felt across the hospitality sector and beyond, with the measures expected to affect a wide range of venues, including shops, hotels, restaurants, bars, theatres, concert halls and sports grounds.

It is worth noting that although the Bill places the requirement on the person who has control of the premises (usually the operator or occupier), there will also be a requirement for co-operation on those with aspects of control of the premises (e.g., the owner of a premises where not the operator) where necessary to deliver requirements.

The Three-Part Test

Venues will be drawn within the scope of the 'protect duty', as qualifying public premises, if three tests are met.

The first test is the qualifying activity test, and the Bill sets out a large number of activities that will cause a venue to fall within the scope of the new legislation, ranging from use for the retail sale of goods, to the exhibition of a film and the provision of healthcare.

The second test is the eligible premises test, and a venue will be captured if it is either a building or land which has a readily identifiable, physical boundary and is publicly accessible. Temporary events, such as music festivals, are therefore captured under the Bill. Exemptions are made for office buildings and private dwellings.

The third test is the maximum capacity test, and a venue will be captured if it has a public capacity of 100 or more individuals.

The Bill also provides that public events which are not held within an eligible premises, but which are accessible to the public and which have a capacity of 800 or more individuals, will be subject to the new legislation. The Bill refers to these events as 'qualifying public events'.

Standard and enhanced duty premises

The Bill will establish a tiered model, linked to the activity that takes place at a premise or event and its capacity.

Standard duty premises are qualifying public premises with a capacity of 100-799 individuals. The measures which must be implemented by these venues are intended to be low cost, simple-yet-effective activities, which are expected to improve the level of preparedness for an attack. The Bill sets out two such measures:

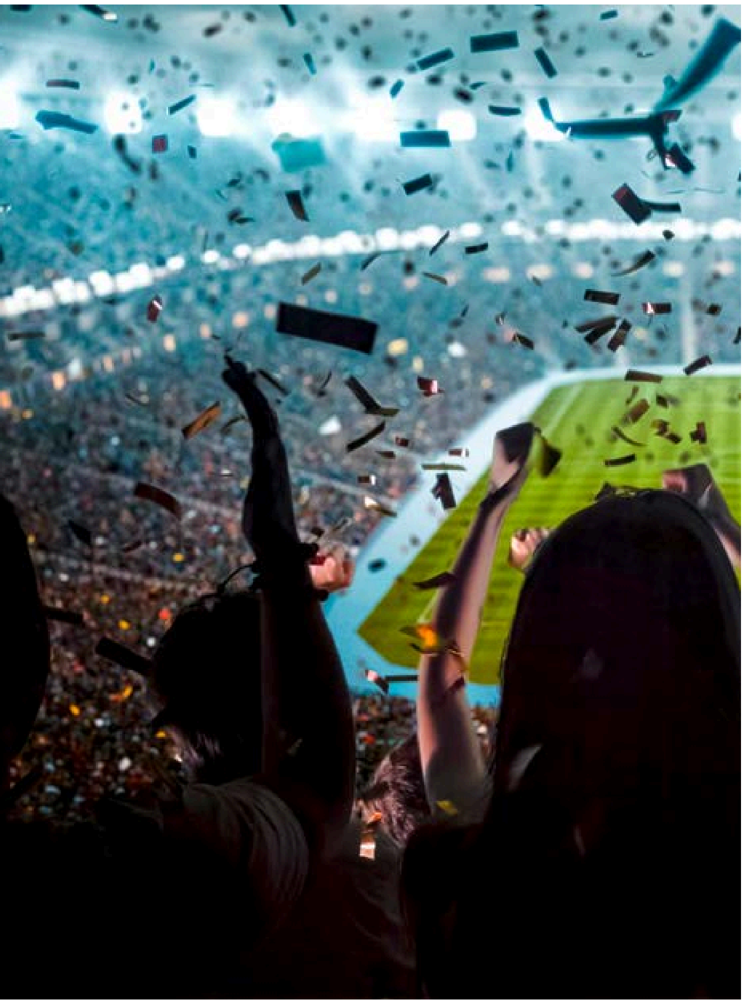
- Registration of the venue as a venue that falls within the scope of the Bill.
- Putting in place procedural measures, to be followed by people working at the premises in the event of an attack, that could be expected to reduce, so far as reasonably practicable, the risk of physical harm to individuals at the premises.

The published draft of the Bill included a requirement for standard duty premises to complete a standard terrorism evaluation, however this has been removed following subsequent consultation, in an attempt to strike the right balance between public protection and avoiding undue burdens on smaller premises.

Enhanced duty premises are qualifying public premises with a capacity of 800 or more individuals. The measures which must be implemented by these venues, as well as those hosting 'qualifying public events', are intended to create a culture of vigilance and security.

The Bill sets out six measures which must be complied with:

- Registration of the venue as a venue that falls within the scope of the Bill.
- Completion of a terrorism risk assessment, which should be reviewed at least once annually (and in the case of qualifying public events, the assessment must be carried out at least three months before the date on which the event is to begin). The assessment should include details of the types of terrorism most likely to occur at the premises or event, the reasonably practicable measures in place to reduce the risk of acts of terrorism happening in the vicinity of the premises or event and the reasonably practicable measures in place to reduce the risk of physical harm in the event of an act of terrorism.
- Provision of terrorism protection training to the relevant workers, which should cover the types of terrorism most likely to occur at the venue or event, the indications that an act of terrorism may be occurring and the procedures which should be followed in the event of an act of terrorism.
- Implementation of reasonably practicable measures in order to reduce the risk of an act of terrorism occurring, and to reduce the risk of harm in such an event. In particular, the Bill specifies measures in relation to the monitoring of, and movement of people within, the premises or event.
- Appointment of a senior designated officer, who must be either the organiser or a person with management responsibilities.
- Completion of a security plan, which must be provided to the regulator, to include details of the premises or event, the senior designated officer, the terrorism risk and any measures which have been put in place.



Enforcement

The identity of the Bill's regulator is yet to be confirmed, although the Bill does set out that the regulator will either be prescribed by the Secretary of State, or will be the Secretary of State. Such regulator will have investigatory powers in order to determine whether the measures set out by the Bill are being adhered to.

If the regulator has reasonable grounds to believe that a requirement has been contravened, the regulator is entitled to hand out a contravention notice requiring the relevant operator to comply within a specified period of time.

The regulator will also have the power to give restriction notices where a requirement has been contravened by an enhanced duty premises or a qualifying public event, and where the notice is deemed necessary to protect the public against terrorism. A restriction notice is a notice which requires the operator to whom it is given to take steps to ensure that the use of the premises is restricted. Examples include restricting the purposes for which the premises can be used or specifying a maximum number of people permitted to access the premises. Whilst a restriction notice may not be put in place for a period of more than six months, the regulator does reserve the right to extend these notices.

Monetary Penalties

The regulator will also have the power to hand out monetary penalties in the form of penalty notices. For standard duty premises, the maximum penalty notice is £10,000. If the penalty relates to an enhanced duty premises or a qualifying public event, the maximum fine will be the greater of £18m and 5% of the operator's qualifying worldwide revenue.

In addition to penalty notices, the regulator may also impose daily penalties. For standard duty premises, the daily penalty may not exceed £500. For enhanced duty premises or qualifying public events, the daily penalty may not exceed 1% of the amount specified in the penalty notice. The total amount of daily penalties may not exceed the amount specified by the penalty notice.

Offences

Non-compliance with a contravention notice or a restriction notice by an enhanced duty premises or a qualifying public event will constitute a criminal offence.

Drawing conclusions

The introduction of Martyn's Law will be felt across the UK's hospitality sector and beyond. The new 'protect duty' should complement current health and safety legislation, and will be welcomed as a necessary step to enhance public safety at large venues and events. The impact of the Bill on enhanced duty premises and qualifying public events in particular, however, will not be trivial. The measures which must be implemented by these operators are significant, and the penalties for non-compliance will be heavy.

Operators of such venues and events should familiarise themselves with the proposed measures and get ready to work on implementation. We are told that dedicated guidance and support will be provided for Martyn's Law, to ensure that those in scope have the required information on what to do and how best to do it, although it is not known at this stage when that will be available.

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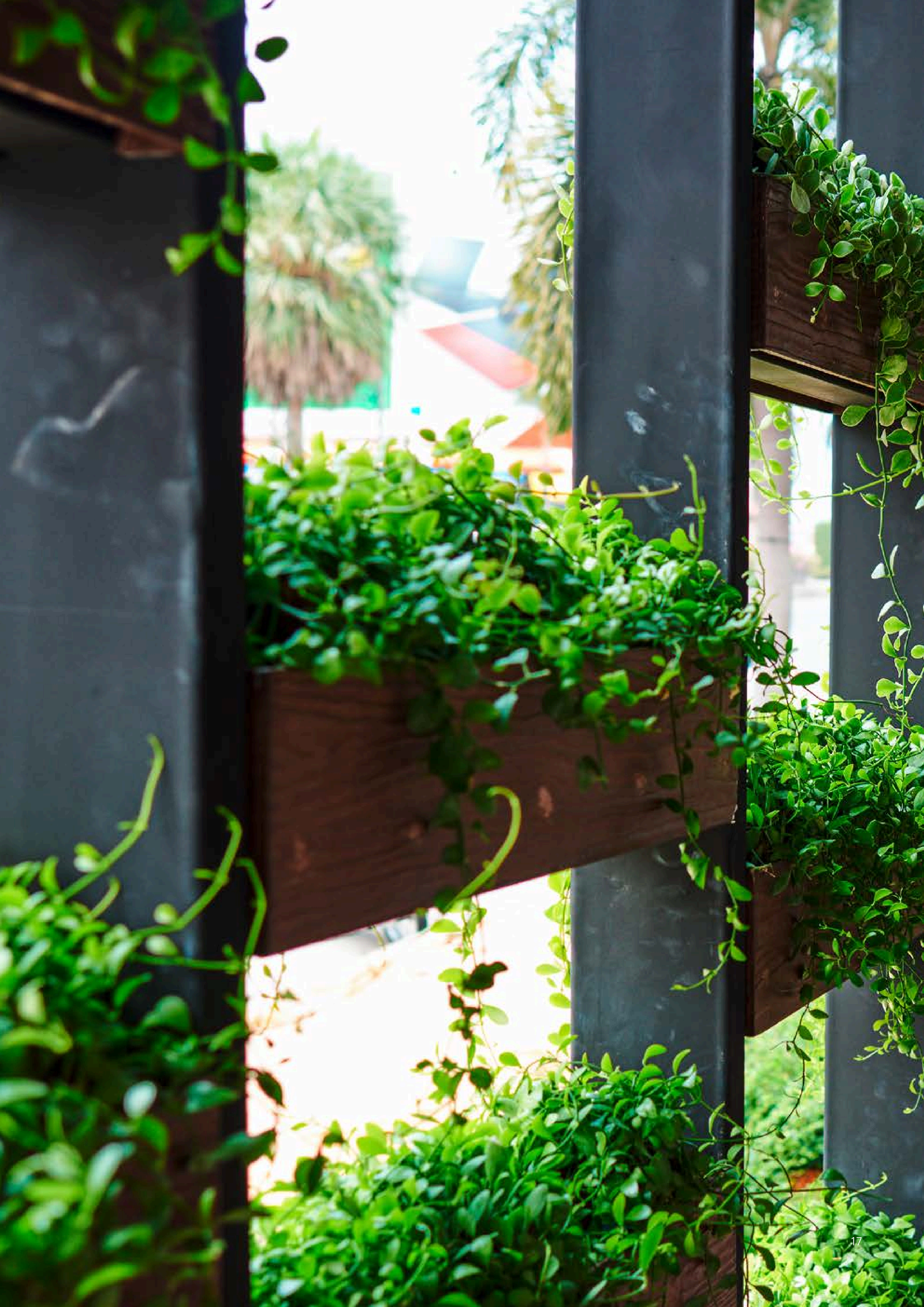


Green Agreements

In recent years, the UK's Competition and Markets Authority ("CMA") has shown an increasing interest in the potential impact of competition law on companies' willingness to collaborate on sustainability initiatives. With ESG firmly on the corporate agenda, the CMA's recent 'Green Agreements Guidance' is designed to provide clarity to companies on the application of competition law to sustainability-focussed agreements between competitors.

The hospitality and leisure industry faces significant challenges and opportunities in achieving its sustainability objectives. In last year's edition of this report, we discussed the ever-changing environmental and sustainability landscape which hotels, pubs, restaurants, and other leisure venues must adapt to. This article will discuss how the CMA's new Green Agreements Guidance (the "Guidance") applies to businesses in the industry, and provide some examples of the types of agreements it could facilitate.

The Green Agreements Guidance

The Guidance applies to agreements or concerted practices between competitors which aim to prevent, reduce or mitigate adverse impacts on the environment, but which may also have the effect of constraining competition between competitors. Examples of these agreements include those aimed at improving air or water quality, conserving biodiversity and natural habitats, or promoting the sustainable use of raw materials. The CMA has identified three categories of agreement, which this article will assess in light of examples applicable to businesses in the hospitality and leisure sector.

Agreements unlikely to breach competition law

The Guidance states very clearly that sustainability agreements between competitors will be unlikely to breach competition law where they do not affect the main parameters of competition (i.e., price, quantity, or quality etc.) or do not have an 'appreciable adverse effect' on competition (i.e., where the parties have a small combined market share).

The Guidance helpfully provides a range of examples of sustainability agreements that do not, or are unlikely to, affect competition. Those that do not affect competition include agreements between competitors that relate to the internal conduct of their businesses. In the hospitality industry, this could include a joint initiative to eliminate single-use plastics in the back-office.

Those agreements that are unlikely to have an adverse effect on competition include the creation of non-binding and transparent industry standards or the pooling of information on the sustainability credentials of suppliers. Restaurant businesses, for example, could benefit from this guidance to agree to phase out non-sustainably sourced produce and share information about their suppliers regarding sustainability. Hospitality businesses, on the other hand, could agree to set industry targets regarding food waste or laundry cycles.

Agreements that may breach competition law

The Guidance also includes a caution regarding agreements which have the 'object' of restricting competition. It warns that environmental sustainability agreements which involve price fixing or market allocation will be manifestly anti-competitive. An agreement between restaurants as to the price at which they will sell products of an agreed environmental standard, for example, will have the 'object' of restricting competition. Similarly, agreements to limit innovation in the field of a competing sustainability-enhancing product will be unlawful.

Where agreements fall short of these more blatant breaches of competition law, the question is a bit more nuanced. Agreements may still have an appreciably negative effect on competition and be unlawful if, for example, the businesses involved have considerable market power or exchange competitively sensitive information which is not necessary for the performance of the agreement.

Sustainability agreements which are capable of exemption

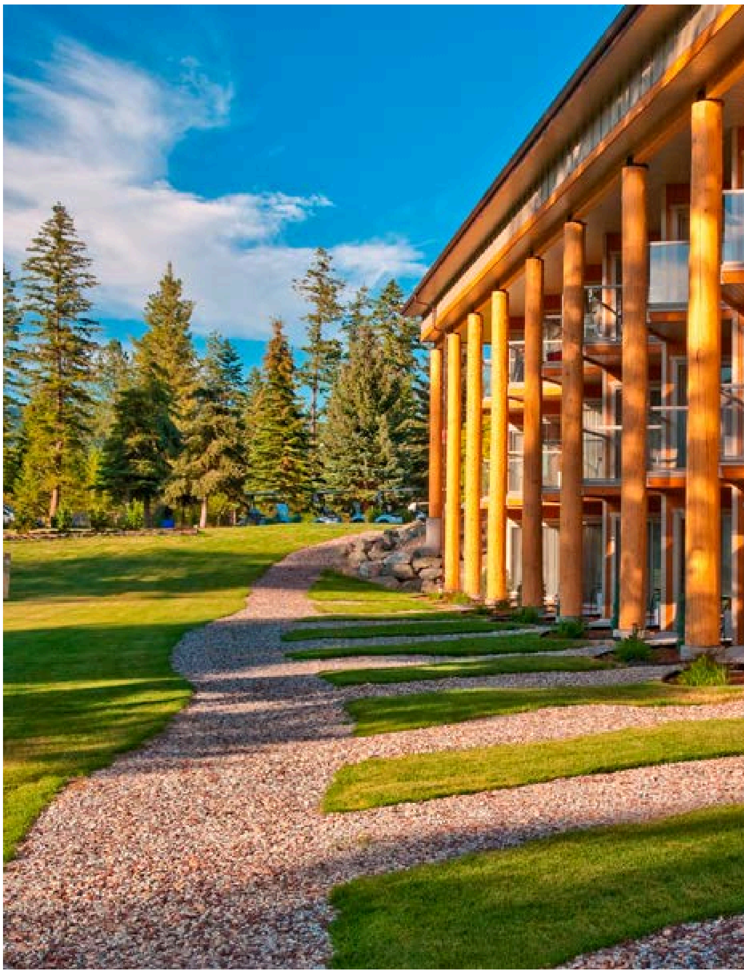
Nonetheless, there are circumstances where a sustainability agreement that has the main purpose or effect of restricting competition will be permitted if the business can demonstrate that it meets the following four conditions.

Contributes certain benefits that outweigh the harm to consumers

Benefits can include the reduction of harmful effects arising from production of unsustainable goods. One listed example is reducing production or distribution costs by combining resources to create a more environmentally sustainable input. This could be taken advantage of by a group of hotel businesses coming together to self-supply more sustainable products more cheaply.

Any restrictions of competition are indispensable to the achievement of those benefits

This means that there must be no less restrictive, but equally effective, alternative. For example, the aforementioned agreement between hotels to adopt a more sustainable input may be indispensable if that agreement enables them to achieve economies of scale by significantly increasing the demand for the more sustainable input (through a lower final sales price) and generate incentives that would not exist without the agreement.



By contrast, where there are already incentives businesses to develop a sustainable product individually, an agreement involving cooperation between various parties may not be indispensable.

UK consumers receive a fair share of the demonstrable benefits

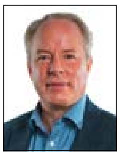
These benefits can include current and future benefits that accrue to direct as well as indirect users. Consumers of a product/service may benefit indirectly where they value the broader environmental sustainability benefits of the agreement for others outside the market.

An example given by the Guidance can be applied to the hotels agreement discussed above. Where businesses agree not to import furniture made from wood grown unsustainably, the higher cost of this furniture may be passed on to hotel guests through higher booking fees. Nonetheless, guests may be willing to pay this additional cost because they value the indirect benefit of not contributing to deforestation through their stay. In this example, the hotel businesses would be expected to provide evidence to demonstrate that consumers value this indirect benefit (e.g., through customer surveys).

Does not eliminate competition in respect of a substantial part of the products covered

In other words, there must be meaningful remaining competition on the market affected by the agreement. This condition will be met if there is still scope for the parties to compete on the main parameters of competition, such as price or quality – even if they align other aspects of their competitive behaviour.

It may also be that the elimination of competition is only for a limited period of time. In the hotels example used above, the parties could agree to limit, for a temporary period, the imported supply of one variant of a product, in order to introduce a sustainable substitute into the supply chain.



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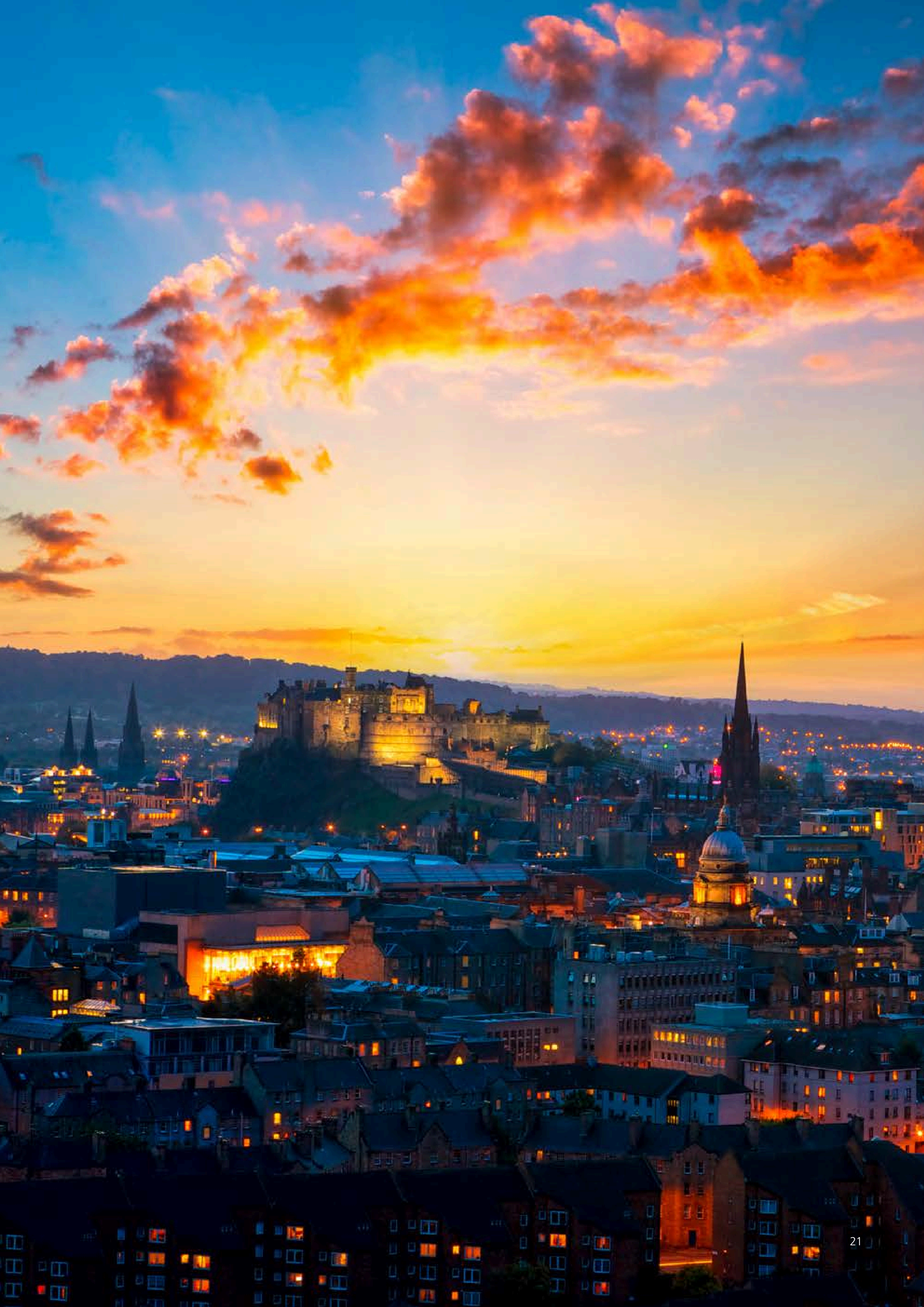
Positive message for businesses looking to be more sustainable

The CMA makes it clear that it does not anticipate taking any action against businesses that enter into sustainability or climate change agreements that comply with the Guidance.

In fact, the CMA actively encourages businesses to take advantage of its new 'open-door policy' and reach out in the event of any uncertainty about whether their sustainability agreement is compliant. The CMA even goes as far as stating that it would not expect to take action where parties approach the CMA to discuss a particular agreement and the CMA does not raise any competition concerns, but the authority later investigates the agreement and finds a breach of competition law.

Combined with the clear examples given by the guidance, businesses in the hospitality and leisure industry can be more confident now when exploring opportunities to become more sustainable. Please contact us if you wish to discuss the opportunities presented by the new guidance.



Regional focus
Tourist tax legislation passed in Scotland

Tourist taxes on overnight accommodation in Scotland are finally set to become a reality. The proposed legislation allowing for their introduction – the Visitor Levy (Scotland) Bill – was passed by the Scottish Parliament in May 2024 and became law in July 2024.

Will there be one regime across Scotland?

No. Despite lobbying by the tourism industry, it will be up to each Scottish local authority whether or not to introduce a visitor levy in its area, the level it should be set and what precisely proceeds should be spent on.

Local authorities are able to set up joint visitor levy schemes with other local authorities. However, given the principle of visitor levies, the level at which they should be set, and what proceeds should be specifically directed at all remaining political hot potatoes, it remains to be seen whether there will be any joint schemes in practice.

How will the visitor levy be set?

It will be a percentage of the cost of overnight accommodation, but not on fees taken by online booking services nor "add-ons" purchased by visitors during their stay such as room service.

The exact percentage will be set by each local authority, which can choose to apply a levy to all of part of its area, develop a system of local exemptions, and set the number of nights at which the levy is charged and the times of year it applies.

However, the Scottish Government also has the power to cap the number of nights to which a visitor levy would apply, after consultation with local authorities, tourism businesses and tourism organisations and Scottish Parliament approval. There is also a Scotland-wide exemption for people receiving disability benefits from the UK or Scottish governments.

The City of Edinburgh Council (CEC) currently looks likely to be the first to introduce a visitor levy – it is currently consulting on a proposed percentage of 5%, capped at seven consecutive nights and applying year-round.

The levy will be collected by accommodation providers on behalf of the local authority.

What will the proceeds be spent on?

Local authorities must reinvest the net proceeds of the scheme in services and facilities largely used by tourists and business visitors.

When will the first levy be introduced?

The earliest any local authority would be able to implement a visitor levy would be spring/summer 2026. That is because an authority must consult with local businesses, communities and tourism organisations when it decides to put the levy in place, followed by an 18 month implementation period. This 18 month period is to allow the authority and, perhaps more importantly, hotels and other accommodation businesses to integrate necessary structural changes to enable the levy to be administered and collected. CEC is currently targeting July 2026 for the launch of its levy.

What has the reaction to the legislation been?

Mixed. Locals in some areas in Scotland – particularly Edinburgh, Skye and the North Coast 500 – are concerned about what they see as overtourism, with one particularly polemical article headline recently suggesting that "tourists have wrecked Edinburgh".

However, others point out, for example, that visitors to the Scottish capital spend £2.7 billion a year, support 30,000 jobs and enable locals to experience and enjoy one of the world's very best cultural eco-systems – and fear that if a visitor levy is set too high, that may dissuade people from visiting.

Scottish legislation regulating short term lettings is also already starting to have a positive impact in reducing disruption to local residents caused by noisy visitors. Although those coming to Scotland already pay a high level of VAT, which has a standard rate of 20%, as well as Air Passenger Duty, the fact that a specific levy is now being imposed on overnight accommodation stays may help dissipate some locals' frustration. For example, CEC's levy alone is expected to raise £45m to £50m a year by 2028/29.

How levy proceeds are spent will be key in determining whether the Scottish hospitality sector can learn to love the tourist levy. Although some eyebrows have been raised at CEC's proposal to allocate £5m of the proceeds per year to "housing and tourism mitigation", CEC's proposals to apply significant chunks of the proceeds to city operations and infrastructure, culture, heritage and events, and destination management have generally been positively received.

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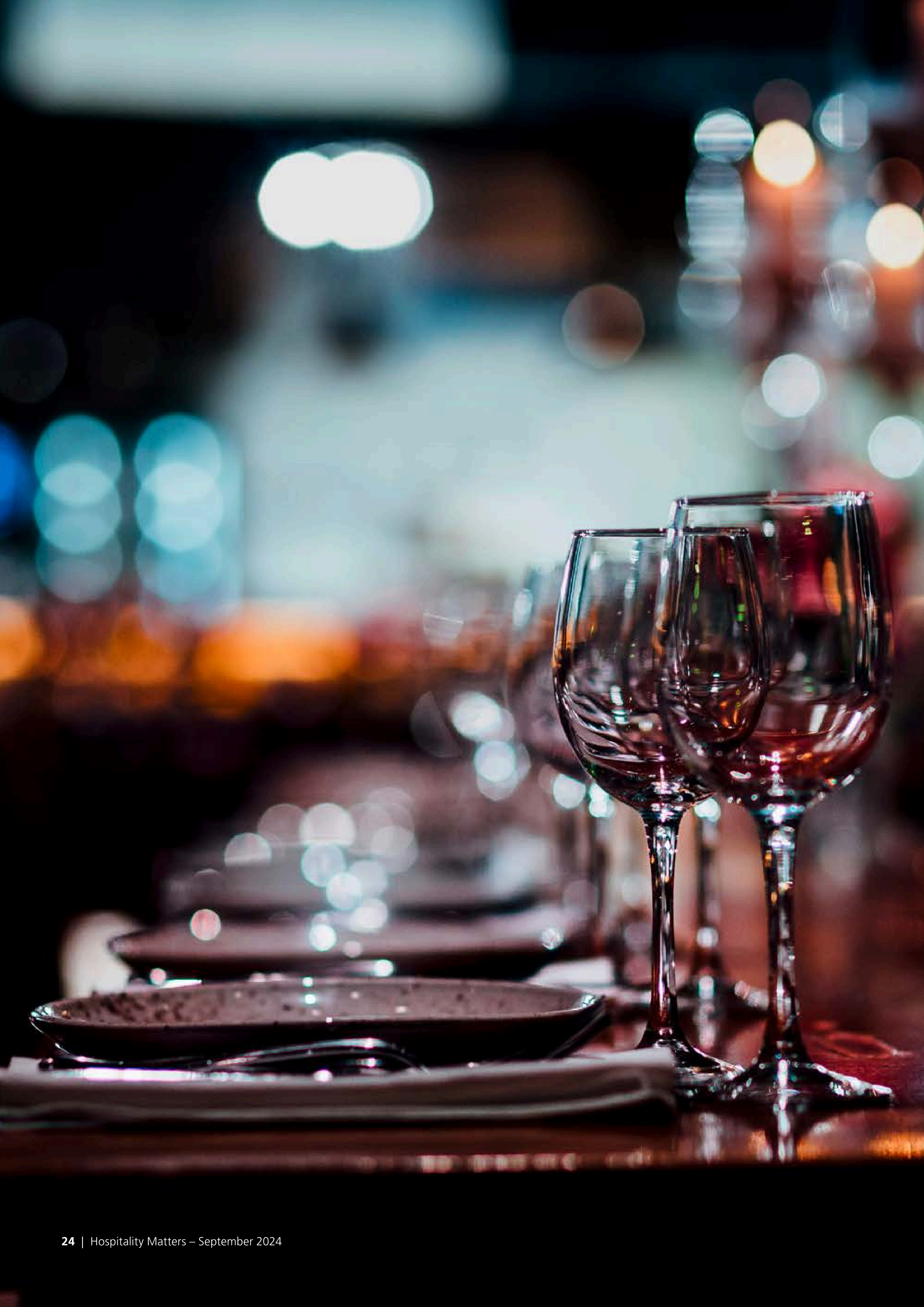


Tipping

An increasingly cashless society and perceived abuse of the tipping system by employers in the hospitality industry has led the UK government to introduce new tipping legislation aimed at enhancing fairness and transparency. While the new regime could mean that workers take home millions of more pounds in tips, employers will have to prepare for challenges regarding the distribution and administration of tips.

Implementation of the Employment (Allocation of Tips) Act 2023 (the "Fair Tips Act"), requiring hospitality employers (among other changes) to pass all tips to workers without deductions, is expected to come into effect on 1 October. This article will explain the changes the Fair Tips Act introduces, how employers should prepare for change, and the potential benefits of the new regime.

The Fair Tips Act

The Fair Tips Act will apply to pubs, restaurants, cafes, bars and other leisure businesses where tips are non-incidental. It states that an employer must ensure that the total amount of "qualifying tips", such as gratuities and service charges that the business exercises control or significant influence over ("Tips") attributable to a place of business is allocated fairly between all employees – including agency workers and zero hours workers. The code of practice makes it clear that not all Tips will be covered by the Fair Tips Act. If an employee is given a cash tip which is not subject to control or significant influence by the employer this will not be covered. If an employer collects cash tips and then distributes them at the end of the shift this would be a qualifying tip.

The key obligations of the Fair Tips Act are summarised here:

— Employers must pay 100% of Tips to their employees;

— Tips must be distributed at the latest by the end of the month following the month in which they were paid;

— Tips must be paid to workers at the same place of work where the tips were received;

— A record must be maintained of all Tips received and distributed for three years;

— Workers will have a right to request an employer's tipping record; and

— The distribution of Tips must be fair and transparent.

The Fair Tips Act left the interpretation of 'fair' to the code of practice, which was published at the end of April 2024. It sets out overarching principles on fairness, and provides a non-exhaustive list of factors employers may wish to consider when distributing Tips. Fairness does not mean that the employer has to allocate the same proportion of Tips to all employees.

Employers can consider the basic pay already received by the employee, hours worked, experience, and performance – as long as these factors are clearly communicated to workers in the employer's tip distribution policy. This policy should be a product of consultation with workers to seek broad agreement as to the system for allocation.

Workers will have the right to bring a claim in the employment tribunal in relation to the distribution and timing of payments of Tips. Interestingly, claims can be brought up to 12 months after the alleged failure, which is an extension to the normal three-month time limit for employment claims. The tribunal may order the employer to revise the allocation to the worker and/or make an order for payment of up to £5,000 to compensate the worker for any financial loss they may have sustained.

Does the current regime need to change?

To understand the impact that the Fair Tips Act will have, it is worth reconsidering the current practices around tipping in the hospitality industry. Calls for change began in 2015 when it became known that tips were not being passed to workers.

With 80% of tipping happening by card, and a large number of employers making deductions from Tips to cover administrative fees (between 2-15%) or even retaining the whole amount, the industry has continued to face criticism . Some employers use the tronc system – a separate pay arrangement used to distribute Tips as agreed between the employer and employees. Troncs are seen as a transparent way of dealing with the distribution of Tips as they are a managed by an independent person (e.g., site manager) who is responsible for determining how Tips should be allocated according to the agreed arrangements. The current regime gives employers the ability to determine the distribution of Tips. Hospitality is a seasonal business, and months such as December and January tend to be stronger performing. Some employers would therefore keep Tips behind in good months to pay out to workers in difficult months. This also applies to lesser performing sites – employers would share Tips collected at more popular sites with workers at less popular sites to ensure fairness across the business. This approach will change with the new Fair Tips Act.

Impact of the Fair Tips Act

Administrative costs

The most obvious impact of the Fair Tips Act is that no deductions can be made to cover the administrative fees of handling Tips, such as credit card charges. These additional costs (of at least 2%) may have a significant impact on a recovering hospitality sector. Businesses may look to make savings elsewhere or pass costs on to customers. This could either be done through increasing prices or a separate 'admin charge' – as long as this charge is voluntary and clearly communicated to customers. The most concerning possibility for workers in hospitality is that businesses ban tipping by card payment entirely. In an increasingly cashless society, this may result in fewer Tips being paid. Businesses should think carefully about how to maintain their bottom line without damaging their reputation or work-culture. After all they have had a long time to prepare for this legislation and mitigate the financial impact of moving towards a system where they absorb the cost of card payments or for the first time share tips with staff.

No ‘smoothing over’ of Tips

The requirement to pay Tips to workers at the latest by the end of the month following the month in which they were paid will mean employers will no longer have the flexibility to retain Tips in strong months to pay out in difficult months. This has a couple of practical implications. It may mean employees find it difficult to budget through the year with varying levels of weekly and monthly income. There is also potential for an exodus of workers after they collect a seasonal upturn in Tips, such as Christmas. Businesses will have to turn to the code of practice to find solutions. For example, payment of Tips could be based on the length of employment, to avoid paying large Tips to those workers who move from business to business on a seasonal basis.

Staff management

Another impact concerns general staff and workplace management. The rule that requires all Tips to be paid at the site where they are collected means that employers will no longer be able to share Tips around their sites. Employers may have to consider offering other incentives to attract workers to their lesser performing sites where fewer Tips are collected. It also comes with an administrative burden as employers will have to track workers that move from site to site within a payment period to ensure that they are paid the correct amount of Tips during each shift.

What are the benefits of the new regime?

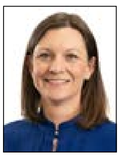
There are benefits to be gained by adopting a fair allocation of Tips to workers. In light of the ongoing challenges with recruitment and retention, fair pay and tipping practices will encourage staff to join an organisation and mean they are less likely to leave. At a time when businesses are eager to demonstrate their ESG credentials, adopting a fair tipping policy is part of a package of ways that an employer can demonstrate that they value their staff.

What businesses can do now

Employers should start preparing now for the new rules coming into force on 1 October 2024. First, businesses should start having an open dialogue with their workers with a view to preparing a tipping policy and ensure that the policy is available to workers at that place of business. This will require careful consideration of the specific business and the fairness factors in the new code of practice. Employers should also ensure that the factors they use to determine the allocation of Tips do not disadvantage certain groups and potentially expose them to indirect discrimination claims. Consulting with workers is particularly important because the code also states that what staff consider as ‘fair’ will be considered if a challenge is brought against the business’s tipping policy.

Another important step is to prepare the business’s administration functions to keep records of the total Tips for each site and budget for the additional cost of credit card charges (if these are currently being taken from collected Tips).

Managers or those responsible for the record keeping requirements should be aware of the timescales and process relating to the worker’s right to request records, and ensure that the appropriate data protection standards are met in relation to the storage of the information and the details that are supplied to workers.



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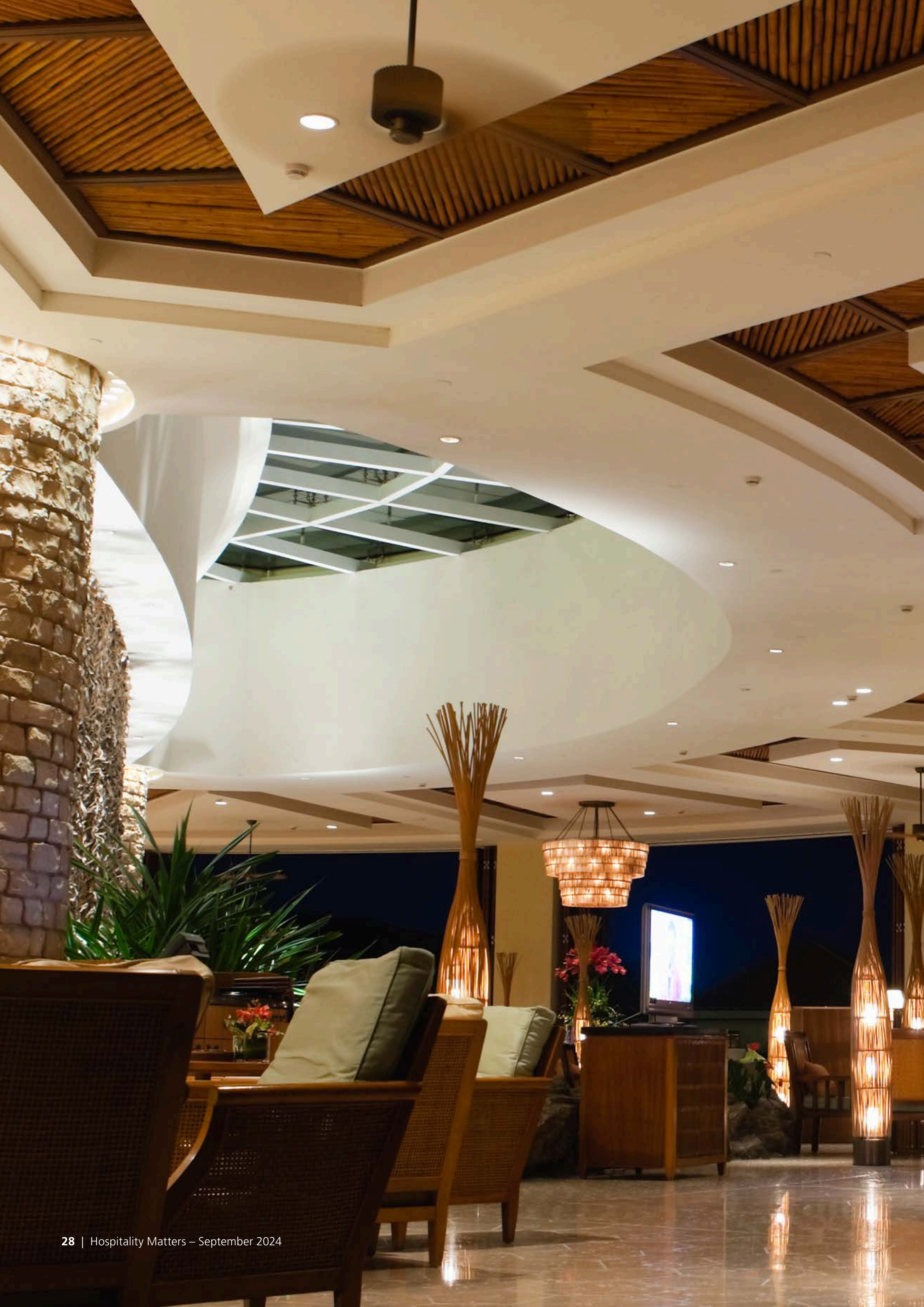


Hot topics

The EU AI Act

The EU AI Act, which will regulate the use of AI systems in the EU, is due to be published in the OJEU on 12 July 2024 and to enter into force on 1 August 2024. The EU AI Act takes a risk-based approach, with certain AI systems banned altogether, and different obligations applying for different risk categories. Specific obligations are included in relation to general-purpose AI models, and there are specific transparency obligations for certain types of AI systems. Different parts of the EU AI Act will start to apply at different times, with organisations only having until 1 February 2025 to get ready to comply with the rules on banned AI. Failure to comply with the EU AI Act could result in fines of up to 7% of total worldwide annual turnover (or, if higher, €35 million), as well as compliance orders (such as requiring withdrawal of the relevant AI system).

Organisations established or located in the UK could still be required to comply with the EU AI Act. For instance, (a) they have developed or are using an AI system and the output produced by the AI system is used in the EU; (b) they are using an AI system developed by someone else but then make certain changes to that system; or (c) they have developed an AI system or general-purpose AI model and have placed it on the EU market or have put into service in the EU.

In contrast with the EU, the current approach to regulating AI in the UK is regulation on a sectoral basis. Regulators use existing laws to regulate AI in accordance with five non-statutory principles and in a manner appropriate to the way in which AI is used in the relevant sector. In order to ensure consistency among the approach taken by different regulators, regulators are expected to apply the five cross-sectoral principles of: (a) safety, security and robustness; (b) appropriate transparency and explainability; (c) fairness; (d) accountability and governance; and (e) contestability and redress. The UK approach to regulating AI is in its relatively early stages and may be subject to change now there has been a change of government after the general election on 4 July.

The Digital Markets, Competition and Consumers Act

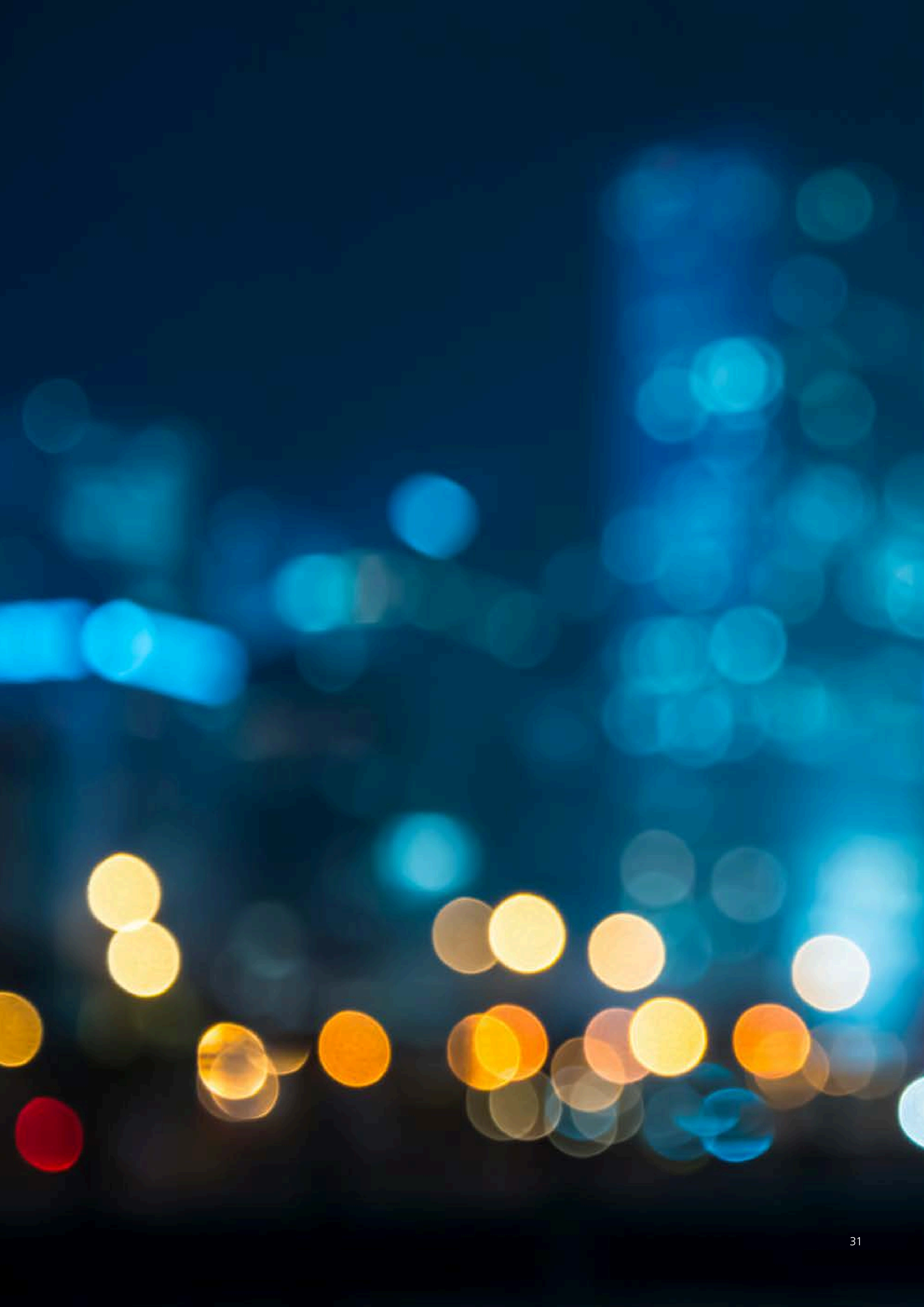
The Digital Markets, Competition and Consumers Act passed into law in May as part of the pre-election washup. It makes major changes to the UK's consumer protection regime. Perhaps the most significant change is to the enforcement of consumer law. For now, the statutory consumer regulator, the Competition and Markets Authority, has to bring expensive and complex court proceedings to enforce the law banning misleading and unfair commercial practices in relation to consumers. When Part 3 of the DMCCA is brought into force by way of secondary legislation, the CMA will be able to impose fines of up to 10% of a company's worldwide turnover on its own initiative, without going to court.

The DMCCA also makes significant changes to substantive consumer law. Importantly for the leisure sector, there are major changes to the law on subscription contracts which will make it easier for consumers to end subscriptions. Traders will have to send reminders to consumers in advance of any free or cheap introductory period expiring, and in advance of subscriptions renewing, in time for the consumer to cancel.

The existing consumer right to a 14-day cooling off period, during which consumers may cancel a contract and get a refund without giving a reason, will apply not only at the start of a contract, but also after the expiry of any free or cheap introductory period, and after the subscription renews. Traders will also have to provide consumers with additional information prior to a subscription contract starting, and accept notice to terminate a subscription contract given by any clear method. The DMCCA also includes new rules on fake reviews, including an obligation to take steps to prevent and remove fake reviews.

Misleading advertising, and other unfair commercial practices, are about to become a business critical, board-level issue, and businesses should be prepared. Steps to consider include:

- Reviewing practices and consumer terms to make sure they are compliant with the new rules on subscription contracts;
- Reviewing processes for the vetting of consumer reviews; and
- Educating marketing teams, and the board, on the substantially increased risk in relation to misleading advertising.



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