

CHAPTER 6

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THE STAFF MEETING had been going well. Trisha Sangus, general manager of the hotel, sat at the head of the conference table. The heads of sales and marketing, food and beverage, security, engineering, front office, and housekeeping were all in attendance, as was the property controller.

Trisha enjoyed the weekly meeting. It gave her a chance to learn from each of her colleagues, as well as to help her to guide their development. She knew that several of them had an interest in someday serving as a general manager, and she realized that an important part of her job was helping to give them the skills and knowledge they would need in their future careers. Some of them were almost ready for the next level of management, while others still had to master some of the basics they would have to face as a general manager.

Trisha was about to launch into a discussion of a proposed change she wanted to make in the type of background music playing in the lobby area when Walter Lott, the chief maintenance engineer, spoke up: "Ms. Sangus, I almost forgot—the garage called this morning on the van."

"This won't be good," thought Trisha. The hotel's 17-passenger van was only three years old but had already accumulated over 250,000 miles, due to a constant series of trips transporting guests to and from the airport. Maintenance costs had been averaging \$500 a month. Fortunately, the van's engine had been holding up well, given its high number of miles. The van drivers had noticed a defective headlight in yesterday's daily inspection, and while the van was in the shop, the chief engineer had asked the service technician to investigate a periodic slippage in the transmission that prevented the van from accelerating properly.

Walter Lott continued, "It's the transmission alright, and the drive shaft. I think we can get it back in service for about \$2,500, but I wanted to check with you first."

"Let's buy a new van," said Mr. Dani, the front office supervisor. "The old one is really starting to show its age."

"It's not in the capital budget," said Ms. Waldo, the controller, with a sigh.

"Well," said Mr. Ray, director of security, "if it stops running completely, you'll just have to use the 'Somewhere Account'!"

As the laughter died down, Mr. Dani asked, "What's the Somewhere Account?"

Trisha replied wryly, "It's the account we use when we have to find the money somewhere, because we have no choice. It's a figure of speech."

"How about a lease?" asked the executive housekeeper.

"That's too expensive," said the food and beverage director. "It's like renting an apartment instead of buying a house. Always buy, that's what my father told me."

"I thought leasing was less expensive," the executive housekeeper replied. "That's what my car dealer told me."

"Don't we save on taxes by leasing?" asked Mr. Dani.

"I wouldn't lease," said the food and beverage director, "unless the auto dealer pays for the repairs; otherwise, it's too expensive."

"But I thought we didn't have the funds anyway," said the sales and marketing director.

"Ms. Waldo said we don't have the capital funds in the budget," Trisha replied. "There are other funds. But before we do decide to lease or buy a new van—if that's in fact what we should do—we need to talk about the differences between leasing and buying."

Trisha knew her one-hour meeting was about to become a two-hour gathering, but she also knew, from the comments around the table, that her staff needed to understand some basics about property, leasing, and buying.

"Listen," she began. "There is a world of difference between buying and leasing a van, or anything else the hotel needs. I'll tell you why. . . ."

IN THIS CHAPTER, YOU WILL LEARN:

1. The difference between real property and personal property.
2. The function of the Uniform Commercial Code when buying property.
3. The role of liens and financing statements in protecting rights of buyers and sellers in purchasing property.
4. How to evaluate the purchase-versus-lease decision from a legal perspective.
5. How to avoid infringement of trademark, patent, copyright, and concept rights.

6.1 INTRODUCTION TO PROPERTY

In the hospitality industry, when a hotel manager is away from the hotel, it is common to say that he or she is “off property.” Property, in this sense, refers to the grounds and building of the hotel. At the same time, when a guest enters the pool area, he or she may see a sign that states, “Towels are provided for your convenience, but are the property of the hotel.” In this case, property refers to a physical asset owned by the hotel. With so many different meanings and uses of the word, property, and its legal characteristics, is an extremely important concept for a hospitality manager to understand.

In the hospitality industry, there are two types of property the future manager must learn to administer:

- Real property
- Personal property

Within the category of personal property, the two subtypes are tangible and intangible property, as shown in Figure 6.1. A tangible item is one that can be held or touched. Thus, furniture is a tangible form of property, as are land, equipment, food inventories, and a variety of other materials needed to effectively operate a hospitality facility. Intangible items are those that cannot be held or touched but have real value, although that value can sometimes be difficult to establish, such as the goodwill of a business.

Understanding the way the law views property is important because it affects how property ownership disputes and claims are settled, the rights of an individual to use the property as they see fit, and even how ownership of the property is allowed to be transferred.

The law treats *real property* differently from *personal property*, and these distinctions are critical for managers to understand.

Real Property

Real property refers to land and all things that are permanently attached to land. *Real estate* is a related term that is frequently used when referring to real property.

Certainly, the trees on a country club’s land are part of its real estate. So, too, are the ponds, streams, and grassy areas that make up the golf course. *Improvements* are features such as fences, sewer lines, and the like, which are changes or additions to land that make it more valuable.

Fixtures

Although at first observation it appears simple to determine what is real property and what is personal property, at times it is quite complex. This difficulty comes from trying to distinguish between items that were intended to be improvements that are “permanently attached” to the land, as opposed to simply being placed on the land.

Clearly, a chimney built into the golf course clubhouse would be considered permanently attached to the clubhouse building. But would a fan placed on the floor of

LEGALESE

Real property: Land and all the things that are permanently attached to it.

LEGALESE

Personal property: Tangible and intangible items that are not real property.

LEGALESE

Real estate: Land, including soil and water, buildings, trees, crops, improvements, and the rights to the air above, and the minerals below, the land.

LEGALESE

Improvements: An addition to real estate that ordinarily enhances its value.

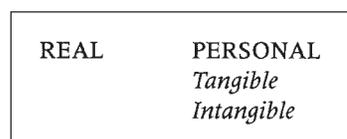


Figure 6.1 Property types.

LEGALESE

Chattel: Personal property, movable or immovable, that is not considered real property.

LEGALESE

Fixture(s): An article that was once a chattel but that has become a part of the real property because the article is permanently attached to the soil or to something attached to the soil.

the dining room be considered permanent? Would a fan affixed to the chimney to improve heat circulation be considered real property? Would it matter exactly how the fan was attached? The answer to these more complex questions comes with an understanding of the legal terms *chattel* and *fixture*.

» ANALYZE THE SITUATION 6.1

JAY GEIER PURCHASED A cinnamon roll franchise from a franchisor. To house the operation, he purchased a small, but ideally located, building from David Stein. The two individuals agreed on a fair price, then both Mr. Geier and Mr. Stein signed the sales contract. Mr. Geier was to take possession of the property on March 1.

On the morning of February 28, Mr. Geier arrived at the property to take some exterior measurements he would need in order to get a contractor's bid on resurfacing the parking lot. He observed Mr. Stein removing a window air conditioning unit from the small manager's office at the rear of the building.

Mr. Geier protested that the air conditioner should not be removed, as it was part of the sale. Mr. Stein replied that the air conditioner was his personal property and was never intended to be sold with the building, nor was it specifically mentioned in the sales contract.

1. Can Mr. Stein be permitted to take the air conditioner?
2. Would the air conditioner be considered real or personal property?
3. Should the air conditioner have been mentioned in the sales contract?

A fan set on the floor of a dining room would not be considered real property because it is clearly movable. Thus, it would instead be classified as chattel. In contrast, a fan that has been permanently installed in the fireplace itself would be considered a fixture. Fixtures include all the things that are permanently attached to property, such as ceiling lights, awnings, window shades, doors, and doorknobs. It is important to note that it is possible to remove an item that has been permanently attached to real property. Thus, a ceiling fan that has been permanently installed in a dining room could, of course, be removed. However, from a legal standpoint, an item that is to remain with the property would ordinarily be identified as a fixture.

Questions often arise as to whether certain fixtures and/or improvements are to be considered real property or treated as personal property. The general rule is: If an item can be removed without damaging any real property, the item is generally considered to be personal property. When the issue is not clear, it is best to consult with an attorney skilled in this area of the law.

Personal Property

Anything that is not real property is personal property, and personal property is anything that isn't nailed down, dug into, or built into the land. A restaurant on an acre of ground is real property, but the tables and chairs in the dining room are not. A restaurant building permanently attached to a plot of land is real property. A van used for catering that is parked in the restaurant's parking lot is not.

As previously stated, personal property can be considered either *tangible* or *intangible*. Tangible property is the type that we most often think of when referring to goods owned by a company or individual. Tangible property can be thought of as all of those items that can easily be moved from one location to another. Automobiles, furniture, artwork, and food inventories are all examples of personal property.

Intangible property can be just as valuable as any real estate or tangible personal property. Intangible property includes items such as franchise rights, trademarks, money, stocks, bonds, and interests in securities. A share of Hilton Corporation stock is a tangible piece of paper, but its real value emanates from the fact that it represents an intangible shareholder interest in the Hilton Corporation. Money is also a form of intangible property. A five-dollar bill is a tangible piece of paper, but it represents an intangible interest in the monetary system used in the United States.

To appreciate the importance of intangible property, consider the case of Stanley Richards. Stanley invents a seasoning salt for beef, which chefs around the world agree is spectacular. His wife, Ruth, creates a small, stylized cartoon drawing of a cow for the label of his seasoning. Stanley consults an attorney, who helps the Richards apply for and receive the exclusive right to use Ruth's drawing in their business. Stanley's product is a huge success. Soon, the stylized cow is associated worldwide with creativity, good taste, and uncompromising quality. Millions of people immediately recognize the cow drawing and what it represents. Stanley is approached by a multinational seasoning company that produces seasonings for poultry, pork, and fish. The company would like to use Ruth's drawing on its own products. The company feels that having the drawing prominently displayed on its own products would improve market awareness of its nonbeef seasonings.

The right to use the stylized drawing of the cow, so valuable in this case, is an example of an intangible property right. Although the drawing of the cow itself is easily duplicated and worth only a few cents, what the stylized cow drawing represents is extremely valuable and may not simply be taken from the Richards without their agreement; they, and they alone, have the right to determine how this property can be legally used.

It is important to note that a partnership or company, as well as an individual, can own personal property. Thus, the word "personal" designates that the property is not "real" property. Essentially, personal property could be considered all property that is not "real" or real estate.

6.2 PURCHASING PROPERTY

For the hospitality manager, the buying, leasing, or selling of property occupies a great deal of time. The foodservice director at an extended-care facility will buy property from vendors, such as food, supplies, and equipment, then turn around and sell some of that property—in this case, the food—to the residents of the facility. At the same time, other equipment for the operation may be leased, such as a dishwasher or a soda-dispensing machine. On a much larger scale, the director of operations for a large hamburger chain may be responsible for buying or leasing land on which to put new stores, and buying or leasing the equipment that will go into the new stores, as well as selling off real and personal property that the company no longer needs.

Purchasing Real Property

In order to sell property legally, the seller must have a legal *title* to that property. It is the responsibility of the buyer to verify this right, however; otherwise, the buyer may find after the purchase that he or she does not legally own the property at all!

Whether the hospitality manager is purchasing real or personal property, the establishment of title to the property being purchased is the responsibility of the manager. And although it might appear that title to lands and real estate would be very simple to verify, the process can, in fact, be quite complex.

LEGALESE

Tangible property: Personal property that has physical substance and can be held or touched. Examples include furniture, equipment, and inventories of goods.

LEGALESE

Intangible property: Personal property that cannot be held or touched. Examples include patent rights, copyrights, and concept rights.

LEGALESE

Title: The sum total of all legally recognized rights to the possession and ownership of property.

LEGALESE

Deed: A written document for the transfer of land or other real property from one person to another.

LEGALESE

Warranty deed: A deed that provides that the person granting the deed agrees to defend the title from claims of others. In general, the seller is representing that he or she fully owns the property and will stand behind this promise.

LEGALESE

Quitclaim deed: A deed that conveys only such rights as the grantor has. This type of deed transfers the owner's interest to a buyer, but does not guarantee that there are no other claims against the property or that the property is indeed legally owned by the seller.

LEGALESE

Title search: A review of land records to determine the ownership and description of a piece of real property.

LEGALESE

Bill of sale: A document under which personal property is transferred from a seller to a buyer.

Deeds

Title to real property can be transferred from an owner in a variety of ways, such as through marriage, divorce, death, an act of the courts, bankruptcy, gift giving, or sale. A *deed* is the formal document used to transfer ownership of real property from one person or entity to another. A deed will consist of the date, the names and descriptions of the parties involved in the transfer, the consideration, a full description of the property, and any exceptions to the transfer.

Deeds may be either *warranty deeds* or *quitclaim deeds*. The laws governing deeds vary from state to state; thus, it is important to make sure that legal title to the real property is provided in the deed.

When there is any doubt as to the legitimacy of the title to a property, it is sometimes necessary to conduct a *title search*.

Title Insurance

Even when the ownership of a piece of property is well established through a title search, it is advisable for a buyer to purchase title insurance. Title insurance is a critical part of any commercial or private purchase of real estate. This insurance helps protect the interests of the buyer should another individual claim ownership of a piece of property after the buyer has completed the sale. Title insurance will cover any losses as the result of these claims.

Some common instances where title insurance has protected a buyer include:

- Forgery
- Improper court proceedings
- Survey mistakes
- Missing heirs
- Unfiled liens

Some inexperienced managers confuse title insurance with loan policy insurance. Loan policy insurance protects a lender (such as a bank) from claims against title to the real property, while title insurance protects the buyer.

To illustrate the importance of title insurance, consider the case of William Clark. Mr. Clark has a daughter named Kimberly. When her father dies, Kimberly inherits a piece of land outside a major city. Mr. Clark did not leave a will, but the house he lived in, and the land it rested on, was passed on to Kimberly, his only living heir, by state law. Thirty years later, Kimberly Clark sells the land to Brian Lee, who builds a restaurant on the site. Five years later, Joshua Davidson produces a lien and a will that, he claims, was signed by Mr. Clark. The will clearly states that Mr. Clark wished to leave the land not to his daughter, but to Mr. Davidson, to settle an old debt. In this case, Mr. Lee's claim to the land may be questionable. Title insurance would protect Mr. Lee if the newly produced will were in fact proved to be valid.

Purchasing Personal Property

For the future hospitality manager, purchases of personal property will, in most cases, vastly exceed purchases of real estate. Because this is true, it is very important to have a thorough understanding of the law and practices surrounding the transfer of ownership of personal property.

Bill of Sale

A *bill of sale* is the formal document used to transfer ownership of personal property from one individual or entity to another. As shown in Figure 6.2, the following items are included in a bill of sale:

- Name of seller
- Name of buyer

BILL OF SALE

I, _____, of [name of firm, if appropriate], in the County of _____, State of _____, in consideration of _____ dollars (\$_____), to be paid by _____, of [name of firm if appropriate], the receipt of which is hereby acknowledged, do hereby grant, sell, transfer, and deliver to _____ and his [or her] heirs, executors, administrators, successors, and assigns, forever, the following:

(Description of Property)

I hereby warrant that I _____ [or name of firm, if appropriate] am the lawful owner of the Property, that it is free from all encumbrances; that I have the right to sell the property; and that I will warrant and defend my right to legally convey it against any lawful claims or demands by anyone.

In witness, whereof, I _____, hereunto set my hand, this ___ day of _____ 20_____.

Seller _____

[Signature of individual or authorized representative of firm]

Figure 6.2 A bill of sale.

- Consideration
- Description of the property
- Statement of ownership by seller
- Date of sale

Because a bill of sale is a contract, it can take many forms. In the hospitality industry, it is common for a buyer to agree to buy a certain type of good from a vendor on a regular basis. Consider the case of Renee Miller, the director of housing and food-services at a state-supported university. Renee knows she will need a large amount of ground beef throughout the school year, but because she has limited freezer space, she must take delivery of the beef on a monthly basis. To negotiate the best possible price, she places all of her ground beef business with the same meat wholesaler. Renee executes a special contract for sale of goods with the seller to ensure that the quality, price, and terms she has agreed upon are maintained throughout the year (see Figure 6.3).

A contract developed to transfer ownership of personal property is common when the property cannot be viewed at the time of sale, as in Renee Miller's case, or when the property has not yet been manufactured. For example, if a hotel orders custom-made drapes and bedspreads, they may not be manufactured by the seller until a contract for their sale has been signed by both parties. As is the case with all contracts, the contract for sale of goods should be carefully examined by both the buyer and seller.

It is important to determine exactly when the transfer of ownership occurs in a sale of personal property. Generally, goods are shipped FOB, which means, "free on board." When used, the term refers to the fact that shippers are responsible for the care and safety of goods until they are delivered to the buyer's designated location. Transfer of ownership occurs not at the time of sale in this case but upon delivery.

Notice that in both the bill of sale and the more formal contract for the sale of goods, the seller is not required to provide a title when transferring ownership. This is different from the sale of real property, where a title (deed) is a required part of the transaction. Unlike real property, ownership of personal property is generally assumed by its possession, and it is not customary for the seller to prove his or her ownership rights by a title. An exception to this rule is the sale of motor vehicles.

The term *interstate commerce* merely refers to the movement of property from one state into another state. In order to commit a federal offense, a person must know that the property had been stolen, but he or she need not know that it was moving through interstate commerce.

» ANALYZE THE SITUATION 6.2

AS THE OWNER OPERATOR of a popular Italian restaurant, controlling costs is an important part of your day-to-day activities. Costs of labor, food, and equipment are your direct responsibility. Profit margins are good, but controlling costs is a constant challenge.

At a meeting of the local chapter of the state restaurant association, you see your friend Wayne, who excitedly tells you about a purchase he has just made. Wayne owns and operates an upscale steakhouse in your town. He purchased 50 full-sized stainless-steel line pans for \$2 each from a passing “liquidator.” Wayne tells you that he jumped at the chance to buy them because when new, the line pans cost \$75 each.

When you inquire about the seller, Wayne says that two men simply arrived at his restaurant in a small pick-up truck, with a variety of equipment and small wares in the uncovered back.

“Best of all,” Wayne says with a wink, “as soon as I washed them and put them in with my regular stock, there was no way anyone could tell the difference between the ones I just purchased from the ones I already had!”

Talk at the restaurant association meeting centers on rising food costs and the likelihood of having to raise menu prices. Several operators state that they are seriously looking at price increases. You, too, have been considering such a move. Wayne tells the group that at his place, “We are going to hold the line on price increases this year.”

1. If you had needed them, would you have purchased the pans?
2. What are the legal issues at play here? What ethical issues are at play?
3. If the “sellers” in this scenario are caught and confess to selling stolen merchandise, do you think that Wayne will get to keep his pans?

Because of the severe penalties involved, the prudent hospitality manager will avoid purchasing any property that is sold at far below its real value, is sold at odd times or by questionable salespersons, or is sold when there is doubt as to its origin. If something appears too good to be true, it generally is, and thus should be avoided.

Warranty

Those who sell property often find that any promises they make about that property can help to better sell it. For example, if the human resources manager at the corporate office of a franchise company decides to purchase a copy machine, the promises, or *warranties*, made by the copy machine’s manufacturer may play a significant role in the machine selected. If two copy machines cost approximately the same amount, but the manufacturer of one warrants that it will provide free repairs if the machine

LEGALESE

Warranty: A promise about a product made by either a manufacturer or a seller that is a part of the sales contract.

breaks down in the first two years, while the other manufacturer does not, the warranty of the first manufacturer would probably be a deciding factor in the selection of the copy machine.

When evaluating the final warranty offer, the following questions should be considered: Before signing any contract for the purchase of goods, it is a good idea to determine what warranties, if any, are included in the purchase. When purchasing real property, a deed helps explain exactly what is included with the purchase. In a similar manner, a warranty helps explain exactly what rights are included in a purchase of personal property. It is important to remember that a warranty is part of the sales contract. That is, the intangible rights a warranty offers the buyer are just as real as the property itself.

Because they are part of the contract, it is always important to make sure that any warranties offered verbally are documented in the sales contract. Warranties can be considered to be either expressed or implied. An express warranty is created when a manufacturer makes a statement of fact about the capabilities and qualities of a product or service. These statements can be made either by a salesperson or in promotional literature. Examples include statements such as: “This copier will make 35 copies per minute,” or “This dishwasher uses six gallons of water for each rinse cycle.”

When a seller makes claims about the capabilities of a product or service being offered, that seller is obligated under the law to deliver a product that meets all of the capabilities described. Because express warranties are considered to be part of the sales contract, the law enforcing the truthfulness of warranties is the Uniform Commercial Code, which you read about in Chapter 4, “Business Contracts.” When a buyer relies on factual representations to purchase a product or service, and those statements later prove to be false, then a breach of the sales contract has occurred. Under Article 2 of the UCC, the buyer may be entitled to recover damages from the seller.

The UCC further protects the interests of buyers by requiring that any products sold be fit for use and free of defects. Thus, even if a seller does not specifically claim that his or her products are free of defects, a buyer would expect that any product purchased would be in good working order. This type of unwritten expectation is called an *implied warranty*.

Under Article 2 of the UCC, personal property that is sold must conform to two implied warranties. One implied warranty is that the item is fit to be used for a particular purpose. This is known as an implied warranty of fitness. The second implied warranty is that the item will be in good working order and will adequately meet the purposes for which it was purchased. This is called an implied warranty of merchantability.

In many states, consumers can enforce their rights with respect to implied warranties for up to four years after a purchase. This means that, for the first four years of a product’s life, the seller is liable for any defects or breakdowns of his or her product, including the implied warranties established by the UCC.

The seller has the right to disclaim, or negate, any express or implied warranties by inserting language into the sales contract. The UCC has drafted standard contract clauses that can be used for those situations. As with any sales contract, the disclaimer must be in writing and must be agreed to by both parties.

Just as price is a negotiable part of any contract, so, too, are warranties. It is a good idea to try to negotiate additional warranties before making a purchase. Before buying personal property, it is imperative to understand the warranty offer and to compare warranties from competing brands before making a purchase. Effective hospitality managers seek to negotiate the longest, strongest, most comprehensive warranty possible, and insist that the warranty be in writing.

Managers should try to include as much of the following information as possible in the warranty in order to ensure maximum protection:

1. How long is the warranty?
2. When does the warranty begin?
3. Will it include the charges for the parts and/or labor to make the repairs?

LEGALESE

Implied warranty: An unwritten expectation that a product purchased is free of defects.

4. What parts of the purchase are covered by the warranty?
5. Can you lose the warranty if you do not follow manufacturer guidelines for routine service and maintenance, and who can perform these tasks?
6. Where is authorized service performed?
7. Who pays to deliver the defective product to the repair area?

Figure 6.4 is an example of a warranty a hotel manager might encounter when buying dishwashers for a new extended-stay facility. Notice the promises that are made by the dishwasher's manufacturer.

DISHWASHER WARRANTY

FULL ONE-YEAR WARRANTY

For one year from date of original purchase, we will provide, free of charge, parts and service labor in your place of business to repair or replace any part of the dishwasher that fails because of a manufacturing defect.

FULL TEN-YEAR WARRANTY

For ten years from date of original purchase, we will provide, free of charge, parts and service labor in your place of business to repair or replace the tub or door liner if it fails to contain water because of a manufacturing defect such as cracking, chipping, peeling, or rusting.

LIMITED SECOND-YEAR WARRANTY

For second year from date of original purchase, we will provide free of charge, replacement parts for any part of the water distribution system that fails because of a manufacturing defect. Associated inlet and drain plumbing parts are not covered by this warranty. You must pay for the service trip to your place of business and service labor charges.

This warranty is extended to the original purchaser and any succeeding owner for products purchased for in the 48 mainland states, Hawaii and Washington, DC. In Alaska, the warranty is the same except that it is LIMITED because you must pay to ship the product to the service shop or for the service technician's travel costs to your place of business.

All warranty service will be provided by our Factory Service Centers or by our franchised Customer Care servicers during normal working hours. Check the White Pages for XXXX COMPANY OR XXXX COMPANY FACTORY SERVICE.

What Is Not Covered

Service trips to your place of business to teach you how to use the product.

Read your Use and Care material. If you then have any questions about operating the product, please contact your dealer or our Consumer Affairs office at the address below, or call, toll-free: 1-800-xxx-xxxx.

Improper Installation. If you have an installation problem, contact your dealer or installer. You are responsible for providing adequate electrical, plumbing, and other connecting facilities.

Replacement of fuses or resetting of circuit breakers.

Cleaning or servicing of air gap device in drain.

Failure of the product if it is used for other than its intended purpose.

Damage to product caused by accident, fire, floods, or acts of God.

WARRANTOR IS NOT RESPONSIBLE FOR CONSEQUENTIAL DAMAGES.

Some states do not allow the exclusion or limitation of incidental or consequential damages, so the above limitation or exclusion may not apply to you. This warranty gives you specific legal rights, and you may also have other rights, which vary from state to state. To know what your legal rights are in your state, consult your local or state consumer affairs office or your state's attorney general.

Figure 6.4 Manufacturer's warranty.

6.3 FINANCING THE PURCHASE OF PROPERTY

The buying and selling of property is fairly straightforward when the buyer pays the seller the entire purchase price all at once. It is more complicated, however, when the buyer decides to pay for property over time. Consider the case of Bill Humphrey. Mr. Humphrey operates a 400-room hotel in the downtown area of an extremely large city. Mr. Humphrey determines that the ice machines in his hotel must be replaced. The cost will be in excess of \$100,000. His controller advises him that the hotel cannot afford to purchase the ice machines for cash at this time, but could afford to make monthly payments toward the purchase price. Mr. Humphrey approaches the hotel's bank, explains the problem, and secures a loan to purchase the ice machines.

In this scenario, a number of problems could arise. What if the hotel cannot make its loan payments? What rights would the bank then have? Could it retake possession of the ice machines? These and other complications can arise any time personal property is financed.

Debtor and Creditor Relationship

LEGALESE

Lien: A claim against property that gives the creditor (lien holder) the right to repossess and/or sell that property if the debtor does not repay his or her debt in a timely manner.

A *lien* is the right of a person to retain a lawful interest in the property of another until the owner fulfills a legal duty. If, for example, a restaurateur purchases new tables and chairs from a seller, but elects to pay one half of the purchase price at the time the tables are delivered and the other half over a period of six months, the seller would retain a lien on the tables and chairs. That is, the seller would maintain a lawful ownership interest in the chairs until they were paid for in full. Of course, since the tables and chairs are housed in the restaurant, the restaurateur would also have partial ownership and rights to the property. In this scenario, two parties have legitimate and legal claims to the ownership of the tables and chairs. This complex relationship of dual ownership can be made easier to grasp with a better understanding of collateral and liens.

Collateral and Liens

Collateral is an asset a person agrees to give up if he or she does not repay a loan. A lien is a claim against the property (the collateral) used to ensure payment of a debt. Liens can be recognized by contract, from general trade practices, or implied by law.

The process of legally recording a contractual lien is known as “making the lien *perfect*,” or *perfecting the lien*. The possessor of a lien, who files the appropriate records with the proper public office, is known as a secured creditor. This type of creditor has a superior right to possession of the collateral or any proceeds if the collateral is sold.

Perfecting a lien implied by law is done by taking possession of the property. If, for example, an in-room air conditioning unit is taken to a repair facility, the repaired unit will normally stay in the possession of the service facility until payment for the repairs has been made.

Other liens include judgment liens, which are those ordered by the courts, and landlord liens, whereby a landlord can secure payment of rent by taking a tenant's property if necessary. In most states, mechanics or persons who furnish materials for buildings are entitled to a lien. In some states, these claims must be filed in the office of the clerk of the court, or established by a suit brought within a limited time. Upon the subsequent sale of the building, these liens, if properly filed, are paid.

LEGALESE

Collateral: Property that is pledged to secure the repayment of a debt.

LEGALESE

Perfect a lien: To make a public record of a lien, or to take possession of the collateral.

Mortgages and Deeds of Trust

When financing the sale of real property, the creditor will generally insist on securing the debt with a lien backed by collateral. In most cases, the lien will be filed on the real property being purchased. For example, if Marion Pennycuff wishes to

purchase land and a building in which to house a café, he could secure funding for this purpose from a bank, providing his financial position is good. Marion would actually buy the real property with money loaned by the bank, and the bank would file for a *mortgage* lien on the property. In this instance, the land and building would serve as collateral for the loan. In some states, a *deed of trust* is a substitute for a mortgage lien, but it serves an identical purpose.

If Marion should decide to sell the property before he has completely repaid his mortgage, a buyer would not be able to obtain a clear title to the property, until the original mortgage was completely repaid.

Assume, however, that Marion wished to borrow the \$100,000 to begin a consulting company, instead of purchasing the land and building. It is most likely that the bank would still require Marion to provide collateral to secure the loan. This collateral could be in the form of real or personal property that Marion owned, including intangible personal property such as stocks or bonds.

Security Agreements

When creditors retain some legal rights of ownership in a piece of personal property, they are said to have a *security interest* in that property.

When personal, rather than real, property, is involved, creditors protect and establish their interest by means of a security agreement. The *security agreement* is an arrangement similar to the mortgage or deed of trust. In it, the creditor makes a loan, and the debtor agrees to pay back the loan in a timely fashion. If the debtor doesn't, then the creditor has the right to seize the personal property, sell it, and apply the money generated by the sale to the debt. The debtor is still responsible for any remaining balance.

Article 9 of the Uniform Commercial Code is the law that regulates purchases made using security agreements and that gives a creditor the right to take back property that the debtor either cannot or will not pay for. As with other areas, the UCC requires debtors and lenders to follow specific procedures in order to finance the purchase of property in a way that is legally binding and that will be upheld by the courts. For example, because it is a contract, the security agreement must include a written description of the property that is being purchased, and must be signed by both parties.

Financing Statements

Under UCC rules, in order for a security agreement to fully protect the creditor, it must be perfected. This is generally done by preparing and filing a financing statement. A *financing statement* is the tool used in most states to record (perfect), a lien on personal property. These statements are typically filed with either the secretary of state's office and/or the local county recorder of records. To perfect their lien, creditors file a financing statement, or UCC-1 form, with the appropriate official. The filing of the UCC-1 form publicly states that a lien exists on a particular piece of personal property.

Unless otherwise indicated, the financing statement remains in effect for five years. When the loan has been paid off, the debtor can request a termination statement that clears the financing statement from the public records.

Figure 6.5 is a copy of the UCC-1 form currently in use. Note that it lists the debtor, the creditor (secured party), and a description of the property that serves as the collateral.

If a creditor has been asked to use a piece of personal property as collateral for a loan, he or she can review the financing statements on file at the office of the governmental agency retaining these records. If creditors find that no previous liens have been recorded against the property, they can be assured that they will have perfected their interest in the property when they properly file a UCC-1 on that property.

LEGALESE

Mortgage: The pledging of real property by a debtor to a creditor to secure payment of a debt.

LEGALESE

Deed of trust: Used in some states instead of a mortgage. A deed of trust places legal title to a real property in the hands of a trustee until the debtor has completed paying for the property.

LEGALESE

Security interest: A legal ownership right to property.

LEGALESE

Security agreement: A contract between a lender and borrower that states that the lender can repossess the personal property a person has offered as collateral if the loan is not paid as agreed.

LEGALESE

Financing statement: A formal notice of a lien being held on personal property, required under the Uniform Commercial Code in most cases. Also called a UCC-1 because of its form number in the UCC.

UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A. NAME & PHONE OF CONTACT AT FILER [optional]

B. SEND ACKNOWLEDGMENT TO: (Name and Address)

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S EXACT FULL LEGAL NAME - insert only <u>one</u> debtor name (1a or 1b) - do not abbreviate or combine names					
1a. ORGANIZATION'S NAME					
OR					
1b. INDIVIDUAL'S LAST NAME		FIRST NAME		MIDDLE NAME	
SUFFIX					
1c. MAILING ADDRESS			CITY		STATE
			POSTAL CODE		COUNTRY
1d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	1e. TYPE OF ORGANIZATION	1f. JURISDICTION OF ORGANIZATION	1g. ORGANIZATIONAL ID #, if any	
					<input type="checkbox"/> NONE
2. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME - insert only <u>one</u> debtor name (2a or 2b) - do not abbreviate or combine names					
2a. ORGANIZATION'S NAME					
OR					
2b. INDIVIDUAL'S LAST NAME		FIRST NAME		MIDDLE NAME	
SUFFIX					
2c. MAILING ADDRESS			CITY		STATE
			POSTAL CODE		COUNTRY
2d. TAX ID #: SSN OR EIN	ADD'L INFO RE ORGANIZATION DEBTOR	2e. TYPE OF ORGANIZATION	2f. JURISDICTION OF ORGANIZATION	2g. ORGANIZATIONAL ID #, if any	
					<input type="checkbox"/> NONE
3. SECURED PARTY'S NAME (or NAME of TOTAL ASSIGNEE of ASSIGNOR S/P) - insert only <u>one</u> secured party name (3a or 3b)					
3a. ORGANIZATION'S NAME					
OR					
3b. INDIVIDUAL'S LAST NAME		FIRST NAME		MIDDLE NAME	
SUFFIX					
3c. MAILING ADDRESS			CITY		STATE
			POSTAL CODE		COUNTRY
4. This FINANCING STATEMENT covers the following collateral:					
5. ALTERNATIVE DESIGNATION (if applicable): <input type="checkbox"/> LESSEE/LESSOR <input type="checkbox"/> CONSIGNEE/CONSIGNOR <input type="checkbox"/> BAILEE/BAILOR <input type="checkbox"/> SELLER/BUYER <input type="checkbox"/> AG. LIEN <input type="checkbox"/> NON-UCC FILING					
6. <input type="checkbox"/> This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS. Attach Addendum (if applicable)			7. Check to REQUEST SEARCH REPORT(S) on Debtor(s) (ADDITIONAL FEE) (optional)		
			<input type="checkbox"/> All Debtors		<input type="checkbox"/> Debtor 1 <input type="checkbox"/> Debtor 2
8. OPTIONAL FILER REFERENCE DATA					

FILING OFFICE COPY — NATIONAL UCC FINANCING STATEMENT (FORM UCC1) (REV. 07/29/98)

Figure 6.5 Financing statement excerpt from Uniform Commercial Code.

It is common in the hospitality industry to buy personal property with a loan from a third-party creditor, such as a bank, or to have the purchase price financed over time by the seller. If, for example, you, as a manager, wish to purchase \$30,000 worth of cash registers for a new restaurant, you have three options:

1. *Pay seller purchase price in full.* No UCC-1 required.
2. *Borrow purchase price from a third-party lender (such as a bank), and pay seller in full.* The third-party lender (bank) files UCC-1 on the cash registers, evidencing its lien on the registers.
3. *Convince seller to finance purchase price over time.* The seller files UCC-1 on the cash registers, evidencing its lien on the registers.

6.4 LEASING PROPERTY

Just as it is common to buy personal property in the hospitality industry, it is equally common to *lease* it. Both real and personal property can be leased.

Because a lease is a type of contract, it must clearly indicate the item to be leased, the price or rent to be paid, and the consent of the two parties to the lease—the *lessor* and *lessee*. A lease is different from a purchase of property in that leases transfer possession, rather than ownership. It is critical that hospitality managers fully understand the essential terms of any leases they enter into, and the differences inherent in leasing, rather than owning, a piece of property.

Essential Lease Terms as a Lessor

Hospitality managers take on the role of a *landlord* when they designate specific space in their hotel or restaurant to be operated by a *tenant*. Historically, hotels would lease lobby space to businesses that would interest their guests. Thus, tailors, dressmakers, jewelers, furriers, and the like would occupy hotel space and provide additional revenue for the property. Additionally, parking lot operators might lease the hotel's parking spaces.

More recently, in an effort to satisfy guest demands for regional or nationally known restaurants, some hotels have begun leasing their entire foodservice operations. In addition, airports and shopping malls have become landlords for well-known, or “branded,” foodservice concepts that appeal to a variety of guests.

When hospitality managers take on the role of landlord, it is critical that the lease contracts they enter into be reviewed by legal counsel prior to signing. An attorney can help ensure that the duties of both landlord and tenant are clearly spelled out in the lease, and that in the event of a breach of the agreement, appropriate remedies are available to the landlord. Consider the case of Michael Singh. Mr. Singh serves as the general manager of a 400-room hotel. Mr. Singh elects to lease his gift shop to an elderly couple with excellent references, and they operate the gift shop successfully for several years. Through no fault of their own, illness causes the couple to become less prompt in opening the gift shop. In fact, on a few days within the past two months, the shop has not opened at all. Mr. Singh knows that the couple's continued inability to open the store could severely damage the hotel's business. The rights of the hotel and the tenant in a situation like this must be clearly documented, so that the hotel manager can take appropriate steps to remedy the problem.

The hospitality lease, especially for real property, is generally different from that of an ordinary landlord and tenant relationship. When a landlord leases a home or apartment, the day-to-day use of that property is normally not subject to the inspection of the landlord. For the hotel operator, however, a lease is drawn up with the expectation that the space will be used for an activity that enhances the financial well-being of the hotel under terms contained in the lease. Thus, operating hours, products sold, and even pricing strategies may be contained in a hospitality

LEGALESE

Lease: A contract that establishes the rights and obligations of each party with respect to property owned by one entity but occupied or used by another.

LEGALESE

Lessor: The entity that owns the property covered in a lease.

LEGALESE

Lessee: The entity that occupies or uses the property covered in a lease.

LEGALESE

Landlord: The lessor in a real property lease.

LEGALESE

Tenant: The lessee in a real property lease.

manager's lease when he or she serves as landlord. While a residential landlord may not impose him or herself unduly on a tenant, the hospitality manager has a responsibility to make sure the tenant operates in compliance with the lease, since the tenant's actions can be helpful or harmful to the success of the entire hotel.

The following areas of a lease agreement deserve special attention when a hospitality manager assumes the role of the lessor (or landlord).

Length of Lease

The lease length is important in that it directly affects rent amounts. Landlords prefer leases that are long because they minimize vacancies and guarantee a steady source of revenue for the use of the space. Increasingly, tenants also prefer long leases to avoid the rent increases that often occur when leases are resigned. However, a lease that is too long may prevent a landlord from raising the rent when necessary. In a like manner, the tenant may find that his or her business grows beyond the ability of the leased space to contain it, and a move to a larger space is required. In all cases, the lease length should be established to meet both the short-term and long-term interests of both parties.

Lease start dates, or occupation dates, should be clearly established in the lease agreement. Often, lessees will want early access to the space in order to install fixtures and make improvements. The number of days required to complete this work can be significant, and the party responsible for rent during that time period, or whether rent is to be paid at all, should be clearly spelled out.

Although it is less common that hospitality managers find themselves as lessors of personal property, sometimes it does occur. An example would be the resort hotel that rents bicycles to its guests. This rental arrangement provides an excellent service to guests but creates special liability issues for the hotel. These issues will be discussed in Chapter 10, "Your Responsibilities as a Hospitality Operator to Guests."

Rent Amount

Lease payments on real property are typically of four distinct types, based on the payment responsibilities of the lessee:

- A "net" lease is one in which the lessee pays some or even all of the taxes due on real property, in addition to the base rent amount.
- In a "net net" lease, the lessee pays for both taxes and insurance as required by the lessor.
- In a "net net net," or triple-net, lease—the most common type in the hospitality industry—the lessee pays for all of the costs associated with occupying the property, including building repairs and maintenance.
- In a "percentage" lease, tenants pay a fixed percentage of their gross revenue as part of their lease payment. Although some fixed charges might also apply, the unique feature of this lease is its variability. Thus, a hotelier might charge the gift shop lessee monthly rent based on the sales achieved by the gift shop. In this way, rent payments are lower when business is slow for the shop but increase as the business and the lessee succeeds.

It is important that both landlord and tenant understand the costs for which they will be responsible. When leasing personal property, the hourly, daily, monthly, or quarterly payments required should be clearly identified in the lease agreement.

Subleasing Rights of Tenant

Most lessees realize that conditions can change, and they may not be able to or want to fulfill all of the lease terms specified in the lease agreement. Consider for example, the shopkeeper who leases space for a flower shop in an urban hotel. The shopkeeper is very successful and elects to sell her rights to the flower shop space to open a larger shop

in a different part of the city. In this situation, the shopkeeper will want to *sublet*—that is, to transfer or assign to another—her interest in the hotel lease to a new shopkeeper.

The concern of the hotel, as the lessor, is that the new shopkeeper must be able to meet the requirements set forth in the lease. For this reason, it is a good idea for the lessor (hotel manager) to insist that any sublessee demonstrate his or her financial strength and integrity before the lessor approves the sublease arrangement.

While it would not be reasonable for the lessor to have complete say over who the sublessee may be, it is also not reasonable for the choice of sublessee to be left solely in the hands of the original tenant. Accordingly, leases should address this issue with a clause acknowledging the right of the lessee to sublease, but only with the landlord's written consent. The clause should also state that the landlord's consent cannot be unreasonably withheld.

Insurance

Landlords are favorite targets for litigation. If a tenant is negligent, and the result is injury to an individual, the lessor must be protected. The size and types of policies that the lessor should require the lessee to purchase vary, but in all cases the lessor should insist that:

- The lessee's insurance carriers must be acceptable to the lessor.
- Copies of the insurance policies should be delivered to the lessor at the time of the lease signing.
- Lessees and their insurance companies should be required to give prior notice to the lessor if the policies are canceled, withdrawn, or not renewed.

In addition, landlords, when preparing leases, may insert exculpatory type clauses that seek to limit their liability. As seen previously, these clauses may not provide complete protection, but they can sometimes be helpful. It is best to have a commercial insurance agent or attorney who is experienced in insurance to review lease provisions and insurance policies to ensure that both lessor and lessee have adequate insurance coverage for the responsibilities allocated to each by the lease agreement.

Termination Rights

Leases may be terminated for a variety of reasons, but these reasons must be clearly spelled out as part of the lease. If, for example, a tenant is delinquent in paying rent, the lessor can require that the premises be vacated. Most landlords will allow the payment to be made a few days later without penalty. This grace period should be clearly identified in the lease, as well as any penalties that will be assessed if the payment is tendered beyond the grace period.

Disturbances, violation of operating hours, significant damage to the property, and failure to abide by lease terms may all be justification for termination. However, while the reasons might be valid, they will not justify an *eviction* unless those reasons are distinctly identified in the lease.

When you, as a hospitality manager, serve as a landlord, the quality of the tenants who supply services to your guests can reflect well or poorly on the overall operation. Capable tenants who operate their businesses in a professional manner can be a real asset to a hospitality property; inexperienced or less-qualified tenants can cause great difficulty. When serving as a lessor, it is imperative that the hospitality manager examine the essential lease terms discussed in this section to ensure the best possible chance of the lessee's, and the lessor's, success.

Essential Lease Terms as a Lessee

When a hospitality manager takes on the tenant role in a lease arrangement, the lease may be for either real or personal property. When Mike Keefer decided to open a steakhouse, he discovered that his own favorite steakhouse was, in fact, for sale.

LEGALESE

Sublet: To rent property one possesses by a lease, to another. Also called subleasing.

LEGALESE

Eviction: The procedure that a lessor uses to remove a lessee from physical possession of leased real property, usually for violation of a significant lease provision, such as nonpayment of rent.

Rather than sell Mike the restaurant, the owner agreed to lease the land, building, and equipment to him in exchange for a percentage of the restaurant's gross sales. This arrangement provided Mike with a lower-cost entry into the restaurant business, and provided the landlord with continued ownership of the restaurant property.

Whether the hospitality manager leases land, buildings, or equipment, such as dishwashers, icemakers, and beverage machines, it is important that an attorney review the provisions of the lease prior to signing. The following items deserve the hospitality manager's special attention when leasing real or personal property.

Landlord Representation and Default

When a tenant leases real property, or an individual leases personal property, it is generally assumed that the lessor has the legal right to lease the property for its intended purpose. The issue of landlord representation and truthfulness, however, can become complex. Consider the case of the restaurateur who examined a property for use as a restaurant. The landlord stated in the lease that the space could lawfully be operated as a "restaurant." After the lease was executed, the restaurateur found that the restaurant's proximity to a school prevented him from obtaining a liquor license. The community zoning laws prohibited selling alcohol near a school. Thus, the landlord's representation that the space could be used as a restaurant was true, but only if that restaurant elected not to serve alcohol. The lesson here is that, as a tenant, any representation made by the landlord about the fitness of property for its intended purpose should be independently verified.

A related concern for lessees is the rights they have if the landlord should lose possession of the property through default. If, for example, a tenant pays his or her rent on time, but the landlord defaults on loans in which the property served as collateral, the rights of the lessee should be addressed in the lease. A clause can be inserted in the lease that guarantees that the tenant's lease will be undisturbed. This is an area of the lease that is best carefully reviewed by legal counsel.

Expenses Paid by Landlord

Whether the lease negotiated is a net, a net net, a triple net, a percentage lease, or some combination thereof, disputes over covered expenses are a common source of landlord/tenant disagreement. Because the landlord has limited ability to reduce expenses during periods of financial difficulty, there are few options available to the landlord when costs must be reduced. If electricity is to be paid by the landlord, it represents a significant expense and should be addressed directly by the hospitality operator. A restaurant consumes a large amount of electricity through cooking equipment, dishwashing, and air conditioning. The lease should clearly identify whether any limits are set on the quantity of electricity that can be used, as well as the types and capacities available.

HVAC is the acronym for heating, ventilation, and air conditioning. In both a net and a net net lease, the repair and maintenance of these items are part of the lease arrangement and are ordinarily paid for by the landlord. The services provided for HVAC maintenance and repair can be critical and should be included in the lease, along with a schedule of times when the services are available.

» ANALYZE THE SITUATION 6.3

SANDY AZNOVARIO LEASED A corner space in a shopping center to operate Olde Style Buffet, an all-you-can-eat buffet geared toward senior citizens and families. The buffet was especially popular on weekends, and its best business was done on Sundays, before and after people in the community normally attended church.

Kathy Miley was the landlord for the shopping center. She and Sandy signed a net net lease, clearly stating that maintenance and repair of the HVAC system would be the responsibility of the shopping center's commercial real estate company.

On Easter Sunday, the Buffet's busiest day of the year, the head cook reported to Sandy that the overhead exhaust system in the kitchen was not working, and the kitchen was becoming unbearably hot, smoky, and humid. Sandy called the landlord's leasing office and heard a recorded message stating the office was closed because of the Easter holiday. Sandy then contacted Beatty's 24-hour Emergency HVAC Repair Service, which sent a representative, who examined the HVAC system, then replaced a broken fan belt on the rooftop exhaust fan.

Sandy submitted the bill from Beatty's, including a triple-time labor charge for holiday service, to Kathy Miley's company for payment. Kathy refused to pay the bill, stating that Beatty's was not the authorized HVAC service company used by Miley, nor did the lease specifically state that HVAC service would be provided on holidays.

1. Who is responsible for this bill?
2. What could have been done beforehand to keep this conflict from occurring?

Like HVAC service and repair, cleaning services, if provided as part of the lease payment, should be clearly identified, and a schedule of cleaning times should be attached to the lease itself. The number of times the restroom is cleaned daily, as well as a definition of "cleaning," should be provided. Does it include floor mopping and the cleaning of toilets and mirrors each time? Or does the cleaning involve only removing large paper debris from the floors? Obviously, a guest will have a different experience under these two alternatives.

It is the responsibility of the hospitality manager who leases space to determine precisely what he or she will get in the way of services included, and expenses paid for, by the landlord.

Terms of Renewal

The terms under which a tenant may renew his or her lease should be of utmost importance to the hospitality manager who finds himself or herself in the role of lessee.

Consider the situation of David Berger. David is the district real estate manager for a chain of muffin shops. As part of his job, David negotiates leases for the company's 800-square-foot operations. More than property leases are managed by David. One of his prime concerns when negotiating a lease is the provision for renewal. If David selects a successful site, he will seek to renew his lease with as little upward change in rent as possible. If the site is less successful, he may elect not to renew the lease, or do so only with a significant reduction in lease payments.

It is important to note that a landlord has no obligation to continue a lease that has expired. Because of that, David often encounters landlords who wish to dramatically increase the rent payments for spaces where the muffin shops have shown great

success. To prevent this, David insists that renewal formulas limiting rent increases to an acceptable amount be written into each lease when it is originally signed.

Normally, a lease can be extended only upon written notice from the lessee. Leases can, however, be written in such a way so as to renew automatically, unless terminated in writing by one of the parties to the lease.

Rights of the Landlord

Most tenants understand that a landlord will have the right to periodically inspect their property. This should, however, be allowed only at reasonable hours, and with reasonable notice. Of even more importance to most tenants is the right of a landlord to lease to a competing business.

Leasing to Competing Tenants

Consider the case of a landlord with a large, 30-store shopping center. It is in the best interest of the landlord to fill all the space with high-quality tenants. The space might even be large enough to house more than one hospitality operation—for example, a bagel shop and a pizzeria.

If, however, the landlord rents space in the shopping center to an upscale bakery, would it be fair for that same landlord to rent space in the same shopping center to a second upscale bakery? Unless the lease of the first bakery expressly prohibits it, the landlord would have the right to lease space to a direct competitor. Although few landlords will give a tenant veto power over any new tenants, it is reasonable to expect that a landlord will allow a tightly drawn definition of any future competitor, in order to help ensure the success of a tenant considering the leasing of space.

Deposits, Damages, and Normal Wear and Tear

Normally, a landlord will require a deposit payment for the lease of real property. Landlords who lease personal property may also require deposits to ensure the return of the leased item in good condition. The amount of the deposit should be clearly spelled out in the lease.

Certainly, tenants must be held responsible for damages they incur on leased property. Tenants should not, however, be responsible for the normal wear and tear associated with the use of a piece of property. Difficulties can arise when the definition of normal wear and tear varies between landlord and tenant. Because it can be a source of conflict, the more detail that can be added to this section of the lease, the less likely it is for litigation to result. Dates by which a landlord must return a deposit upon lease termination, and the appropriate method of resolving disputes about owed amounts, should also be included.

Unfortunately, legal clashes between landlord and tenant are common occurrences. They can be reduced if both parties to the lease carefully consider the essential lease terms that most directly affect the success of the lessor and lessee relationship. When vacancies are high, landlords may be willing to negotiate on terms they otherwise would reject. Likewise, if space is in short supply, tenants may be in a weaker negotiating position. Carefully reviewing lease terms is always a good idea and one that the hospitality manager would be well advised to undertake only with the aid of a qualified attorney.

The Buy-versus-Lease Decision

The decision to purchase or lease a piece of property is an important one. Managerial philosophy can play a large part in this decision. Regardless of whether one elects to own or merely utilize property, the decision has wide-ranging effects on a number of business issues. The most important effects are addressed in the next Legally Managing at Work discussion.

Often, the decision to lease rather than purchase property is an economic one. A new passenger van for a hotel may cost over \$30,000. If the van is purchased, the hotel has undertaken a *capital improvement*. Payments for the van are not deductible as a business expense on the monthly profit and loss (P&L) statement. The value of the van, however, may be *depreciated* over a period of time fixed by law.

LEGALLY MANAGING AT WORK:

Legal Considerations of Buying versus Leasing

1. Right to use

Purchase

Unlimited use in any legal manner seen fit by the owner.

Lease

Use is strictly limited to the terms of the lease.

2. Treatment of cost

Purchase

Property is depreciable in accordance with federal and state income tax laws.

Lease

Lease payments are deductible as a business expense, according to federal and state tax laws.

3. Ability to finance

Purchase

The property may be used as collateral.

Lease

The property may not generally be used for collateral.

4. Liability

Purchase

Owner is liable.

Lease

Lessee and/or lessor may be liable.

5. Improvements

Purchase

Implemented as desired by owner.

Lease

Improvements limited to those allowed by lease terms.

6. Termination

Purchase

Ownership passes to estate holders.

Lease

Right to possess concludes with termination of lease contract.

7. Default

Purchase

Lender retains down payment and/or may foreclose on the property.

Lease

Lessor retains deposit and/or lender may evict and pursue balance of lease. With personal property, the lessor may reclaim the leased item.

LEGALESE

Capital improvement: The purchase or upgrade of real or personal property that results in an increased depreciable asset base.

LEGALESE

Depreciation: The decrease in value of a piece of property due to age and/or wear and tear.

LEGALESE

Commercial lease: A lease that applies to business property.

If a hotel operator wants to replace the air filters located in the ceiling of an atrium-style lobby four times a year, it makes little sense to purchase the mechanical lifts necessary to do the job. These pieces of equipment can be leased for a day and the task can be completed.

By contrast, if a restaurateur wants to operate a restaurant in a prime location in a mall food court, he or she may have no option other than leasing, because the mall owner is not likely to sell the restaurateur the space needed to operate, but rather, will lease the space under a *commercial lease*.

The owner of a piece of property has rights that a lessee does not enjoy. In some cases, however, the effective hospitality manager, for a variety of reasons, may find it desirable to lease a piece of property. In either case, it is important to know and protect the rights associated with each type of property's possession.

6.5 RESPECTING INTELLECTUAL PROPERTY RIGHTS

LEGALESE

Intellectual property: Personal property that has been created through the intellectual efforts of its original owner.

Some of the most important, and personal, property rights protected by law are those that relate to *intellectual property*—personal property that is both intangible and conceptual.

In the hospitality industry, some managers violate intellectual property rights by using, but not paying for, the intellectual property of others. Good managers both avoid infringing on the property rights of others and pay for those intellectual items they legitimately use to assist their business.

When an individual creates something that is unique and valuable, his or her right to enjoy the financial proceeds of that creation is protected by laws related to trademarks, patents, copyrights, and trade dress. It is important to note that intellectual property maintains its status even after the death of the person who created the property.

Trademark

Trademarks are used to identify the producer, manufacturer, or source of a product. They are frequently used in the hospitality industry. The reason is clear: Guests like to see name-brand products in use by the establishments they frequent. Well-established trademarks, or *marks*, as they are sometimes called, let consumers know precisely whose product they are buying or being served. For example, many restaurants find it convenient to serve ketchup directly from the bottle. As a consumer, a bottle manufactured and labeled by Heinz will elicit a much different response from one manufactured by Bob. When consumers see the Heinz name on the label, they associate the ketchup with the quality represented by the Heinz Company. An unscrupulous foodservice manager who buys Bob's ketchup, and then puts it in a Heinz bottle, violates not only food safety laws, discussed later in this text, but trademark property rights laws as well.

The owner of a trademark has the right to prevent others from using that mark, if the owner was the first to use it in the respective marketplace. When a trademark has been properly applied for and received, no other person may manufacture or sell any article using the same or similar signs, marks, wrappers, or labels.

Trademark law protects the public by making consumers confident that they can identify brands they prefer and can purchase those brands without being confused or misled. Trademark laws also protect hospitality managers by ensuring that they are getting the quality they are paying for.

Patent

When an inventor creates something new, he or she may apply for a *patent* on the invention. If, for example, a restaurateur invents a piece of kitchen equipment that can easily peel and remove the center from a large Spanish onion, that restaurateur would

LEGALESE

Trademark: A word, name, symbol, or combination of these that indicates the source or producer of an item. Sometimes called a mark.

LEGALESE

Patent: A grant issued by a governmental entity ensuring an inventor the right to exclusive production and sale of his or her invention for a fixed period of time.

be able to quickly produce one of today's most popular appetizer items. It would not be fair for another restaurateur to see that piece of equipment and proceed to manufacture it for sale him- or herself if the first restaurateur had applied for, and received, a patent on that piece of equipment.

The U.S. Patent and Trademark Office is the federal entity responsible for the granting of patents. An inventor, as the owner of the patent, has the right to exclude any other person from making, using, or selling the invention covered by the patent anywhere in the United States for 17 years from the date the patent is issued. If an inventor has applied for, but not yet received, a patent, he or she may use the term "patent pending" or "patent applied for."

Copyright

A *copyright* is the set of rights given to reproduce and use intellectual property. For example, the writer of a song has a right to compensation any time that song is performed. If a singer takes the song, records it, and then sells the recording, the copyright laws would require the singer to fairly compensate the songwriter who wrote the song's music and lyrics.

Copyright protection was considered so important that the founding fathers of the United States specifically granted the new Congress the responsibility of regulating copyrights. Figure 6.6 is an excerpt from the United States Constitution that addresses the issue of copyrights.

The owner of a copyright has the right to prevent any other person from reproducing, distributing, performing, or displaying his or her work for a specific period of time. The Copyright Act of 1976 states that copyrighted work can be a literary work, musical work, dramatic work, pantomime, choreographic work, pictorial work, graphic work, sculptural work, motion picture, audiovisual work, sound recording, or computer program. Most of the items found on the Internet are copyrighted also, including the text of websites, contents of e-mail, and sound and graphic files.

In 1998, President Clinton signed the Digital Millennium Copyright Act (DMCA) into law. The DMCA amends the Copyright Act of 1976 and incorporates two major international treaties: the World Intellectual Property Organization (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty. The DMCA's main effect is to heighten the penalties for copyright infringement over the Internet, and to criminalize the production and distribution of circumvention technology, and the act of circumvention, whether or not copyright infringement is involved.

When an individual has been granted a copyright, he or she is said to be the *copyright owner*. Copyright laws exist in foreign countries as well as the United States.

In some cases, under the doctrine of fair use, it is legal to use a copyrighted work without permission from the owner, but the purpose of such utilization is very important. A copyrighted work used for commentary, news reporting, teaching, scholarship, or research, is normally not an infringement of a copyright because it is an educational, rather than a commercial, use of the work.

LEGALESE

Copyright: The legal and exclusive right to copy or reproduce intellectual property.

LEGALESE

Copyright owner: A person or entity that legally holds a right to intellectual property under the copyright laws.

The Constitution of the United States of America

Article 1, Section 8

The Congress shall have the power:

to promote the progress of science, and the useful arts, by securing, for limited times, to authors and inventors, the exclusive right to their respective writings and discoveries.

Figure 6.6 Excerpt from the U.S. Constitution.

In the hospitality industry, it is critical that copyrighted works be used only when appropriate authorization has been received, particularly when the use of a copyrighted work—such as the broadcasting of a boxing match—will provide a direct economic benefit to the hospitality establishment. Generally speaking, the courts are aggressive enforcers of copyright laws; thus, it is a good idea to be very clear about the origin and ownership of potentially copyrighted works before they are used in a manner to produce income and profit.

Trade Dress

LEGALESE

Trade dress: A distinct visual image created for and identified with a specific product.

Although the rights related to *trade dress* are actually a part of those rights related to trademarks, in the hospitality industry, they merit separate discussion. A trade dress is a very special and unique visual image.

Trade dress includes color schemes, textures, sizes, designs, shapes, and placements of words, graphics, and decorations on a product or its packaging. In the hospitality industry, an entire restaurant may be created in such a way as to be protected under the laws related to trade dress. The laws in this area can be murky. Certainly, no one restaurant chain has an exclusive right to operate a restaurant with a “down home” theme. A trade dress question arises, however, when one restaurant chain uses the same items to create that feel as does its competitor.

Italian, Mexican, French, and American restaurants, to name a few, all have unique characteristics associated, not with the product served, but with the feel and visual image of the establishment. Trade dress protection allows the creative restaurateur to protect his or her aesthetic ideas in an industry that highly rewards innovation and creativity. For an excellent examination of the trade dress issue, do the following Search the Web exercise. It involves the case of two Mexican-style restaurants, one of which was accused of a trade dress violation.

Search the Web 6.1

Enter lp.findlaw.com.

1. Select: Cases and Codes.
2. Select: US Supreme Court.
3. Select: Party Name Search.
4. In the Search field type: “Two Pesos.”
5. Select: “Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763 (1992).”

Review the intangible property rights Supreme Court case involving Two Pesos, Inc. and Taco Cabana, Inc. Be prepared to describe in class the items of similarity between the two businesses on which the court based its decision.

Preventing Intellectual Property Rights Infringement

LEGALESE

Public domain: Property that is owned by all citizens, not an individual.

In order to prevent infringing on the rights of intellectual property owners, the United States Patent and Trademark Office maintains a database of registered patents and trademarks. Consult that database if there is any question of whether a mark or an invention is in the *public domain*.

If a company does not take care, its trademarks can become part of the public domain. “Aspirin” is often mentioned as a word that began as a trademarked term but later passed into such common usage that the courts would no longer enforce the property rights of the word’s creator. A common word, used frequently by society, cannot become the subject of trademark protection.

Although most hospitality managers can, through thoughtful planning, avoid infringing on patent and trademark rights, copyright issues are more complex. Consider the case of the corporation that owns a theme park with a variety of thrill rides. One of the most popular is a seated ride where four passengers share a padded car that progressively goes faster and faster, traveling up and down on a circular track. The ride is fast, loud, and popular with teenagers. Hundreds of flashing lights and loud music, played by 25 broadcast-quality speakers, are an important ingredient in this ride. The corporation is free to put any type of lighting around the ride that it feels would be appropriate. However, the company is not free to broadcast any music it wishes over the speakers in conjunction with the ride, unless the music is used in compliance with U.S. copyright laws. Figure 6.7 shows the section of the United States legal code that deals with the infringement of copyright.

U.S. Code, Title 17, Section 504

Sec. 504. Remedies for infringement: Damages and profits

In General. - Except as otherwise provided by this title, an infringer of copyright is liable for either:

- (1) The copyright owner's actual damages and any additional profits of the infringer, as provided by subsection (b); or
- (2) Statutory damages, as provided by subsection (c).
 - (b) Actual Damages and Profits. The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.
 - (c) Statutory Damages.
 - (1) Except as provided by clause (2) of this subsection, the copyright owner may elect, at any time before final judgment is rendered, to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work, for which any one infringer is liable individually, or for which any two or more infringers are liable jointly and severally, in a sum of not less than \$750 or more than \$30,000 as the court considers just.

For the purposes of this subsection, all the parts of a compilation or derivative work constitute one work.

- (2) In a case where the copyright owner sustains the burden of proving, and the court finds, that infringement was committed willfully, the court in its discretion may increase the award of statutory damages to a sum of not more than \$150,000. In a case where the infringer sustains the burden of proving, and the court finds, that such infringer was not aware and had no reason to believe that his or her acts constituted an infringement of copyright, the court in its discretion may reduce the award of statutory damages to a sum of not less than \$200. The court shall remit statutory damages in any case where an infringer believed and had reasonable grounds for believing that his or her use of the copyrighted work was a fair use under section 107, if the infringer was:
 - (i) an employee or agent of a nonprofit educational institution, library, or archives acting within the scope of his or her employment who, or such institution, library, or archives itself, which infringed by reproducing the work in copies or phonorecords; or
 - (ii) a public broadcasting entity which or a person who, as a regular part of the nonprofit activities of a public broadcasting entity (as defined in subsection [g] of section 118) infringed by performing a published nondramatic literary work or by reproducing a transmission program embodying a performance of such a work.

Figure 6.7 U.S. Code Title 17, Section 504.

Copyright laws in the United States give songwriters and publishers the right to collect royalties on their intellectual property whenever their songs are played in public. Note that the law allows the owner of the copyright to recover the profits made by any group that unlawfully uses copyrighted material.

Whether a hospitality manager plays songs in an establishment on CDs, television, tape, or in a live performance, the owners of the song have a right to royalties. This is because federal copyright laws state that playing copyrighted music in a public place constitutes a performance. When copyrighted music is performed in public, hospitality managers are in violation of the law if they do not pay the royalties due the owners of the music that has been played.

Of course, it would be extremely difficult for the practicing hospitality manager to know exactly who owns the rights to a particular piece of music. Most of the songs played in the United States are licensed by either Broadcast Music, Inc. (BMI); the American Society of Composers, Authors, and Publishers (ASCAP); or SESAC, which originally stood for the Society of European Stage Actors and Composers, but now is referred to solely by its acronym, pronounced SEE-sack. In order to play a given piece of music, a fee must be paid to the licensor that holds the right to license the music in question. Fee structures are based on a variety of factors, but the average restaurant, playing background music seven days a week, would be expected to pay only a few hundred dollars per year for the right to broadcast most of the music available for play. If the hospitality manager refuses or neglects to pay the fees rightfully due a licensing group, he or she can be subject to fines or prosecution.

Congress has determined that any facility that plays its background music on a piece of equipment that could normally be found in a home will not be held to the normal copyright infringement rules if they do not charge admission to hear the music. Certainly, it is not the intent of the copyright laws to prohibit turning on a simple radio or television in a public place. In 1998, President Clinton signed the Fairness in Music Licensing Amendment, a law that allowed small restaurants an exemption from some licensing fees. The law took effect in January 1999.

The specific provisions of the amendment providing for the free broadcast of music and video are quite clear. Restaurants under 3,750 square feet can play as many televisions and radios as they desire without paying royalty fees. There is no restriction on the size of the television that may be installed in a restaurant of this size. For specific information, visit www.copyright.gov. For restaurants larger than 3,750 square feet, if the owner applies for and receives an exemption, the restaurant may play up to four televisions (no more than one per room), and use up to six speakers (no more than four per room). The television sets cannot be larger than 55 inches.

Many hospitality venues utilize jukeboxes for their patrons' entertainment. It is ordinarily the provider of the jukebox who has the burden of paying the royalties for the music included in the jukebox, but this should be spelled out in the agreement prior to the installation of the jukebox.

Just as music is covered by copyright laws, so too are the broadcasts of such groups as the National Football League (NFL), Major League Baseball (MLB), the National Basketball Association (NBA), and others. The right to air these broadcasts is reserved by the group creating the programming, and the hospitality manager who violates their copyrights does so at great risk. If you have any doubt about the legality of your intended broadcasts, contact the broadcast company (i.e., cable operator) or the owner of the broadcasted product (NFL, Time Warner, etc.) to clarify the circumstances under which you may broadcast and to get written permission to do so.

For hotels, the broadcasting of in-room videos or movies on demand is treated in a similar way to jukeboxes in restaurants. The providers of the service to the hotel operator are ordinarily responsible for paying the royalties from showing the product. Again, this needs to be clarified in the agreement between the provider of the service and the hotel operator.



INTERNATIONAL SNAPSHOT

U.S. Hotel Companies Seeking Trademark Protection May Now File in the United States for Protection Abroad

Most well-known hotel companies earn their profits primarily by managing and franchising hotels, thereby allowing the hotels to operate under the hotel company's "flags." These flags (such as Westin, Marriott, and Hilton) are trademarks. They represent a way of doing business, the hotel company's valuable relationships with its customers, and, in essence, the company's power to deliver economic performance to a hotel. Hotel companies, therefore, consider their trademarks to be among their most valuable assets.

Valuable assets must be protected, and trademarks are no exception. Trademarks are usually protected by registering them in the jurisdictions where they are used. These registrations must then be renewed at intervals prescribed by the laws of the applicable jurisdiction.

Hotel companies often operate hotels internationally. This means that, to protect their marks, they should, at a minimum, register and renew their registrations in each country where the hotels are located. They should also consider "registering defensively" in countries where there is a high "knock-off" risk. Before November 2, 2003, the registration process required a U.S. hotel company to engage in a country-by-country registration process. One shortcut registration process has existed for some time: Companies may register for and obtain a European Community Trade Mark (ECTM), which provides protection in all countries of the European Union for the cost of a single application. But as of that date, U.S. companies were given an additional shortcut alternative to the country-by-country registration process. On November 2, the United States became the fifty-ninth country to implement the Madrid Protocol.

The Madrid Protocol is a treaty that allows trademark holders to file a single application covering all 60 protocol member countries. The resulting International Registration permits some applicants to greatly reduce costs associated with multiple international trademark applications.

Like any trademark protection regime, the Madrid Protocol has disadvantages as well as advantages:

- One-stop Madrid filings through the U.S. Trademark Office are more convenient and initially less costly than filing multiple international applications.
- International registrations offer the same scope of protection as a registration in the applicant's home country. Because U.S. trademark law requires applicants to describe the goods covered by their marks more narrowly than that of other countries, an international registration based on a U.S. application will give a U.S. trademark holder narrower protection in some other countries than non-U.S. trademark owners would receive.
- Because an international application must be based on an original "home country" application, if a U.S. applicant's original U.S. application is refused by the Patent and Trademark Office, or fails for any other reason within five years, the entire international application based on it will also fail. An applicant may refile applications in each individual country while retaining the original filing date, but the fees and costs associated with the original protocol application will be lost.
- If member country trademark offices raise substantive objections to applications for an international registration, local counsel will be necessary to resolve each such objection.
- Madrid filings do not cover countries that are not members of the Madrid Protocol. Some important countries that are not members include Canada and most of Central and South America.

Whether a company should seek international registration under the Madrid Protocol depends heavily on the countries where the company needs protection. If, for example, the company expects to use its mark solely in Europe and the United States, a European Community Trade Mark will provide protection in all countries of the European Union for the cost of a single application, and the costs and benefits of prosecuting a ECTM application will be generally more favorable than those associated with a Madrid filing. If, however, the company requires broad, worldwide protection, an international application may be the best overall approach.

Provided by Irvin W. Sandman, Esq., and Robert C. Cumbow, Esq., of Graham & Dunn's Hospitality, Beverage, and Franchise Team, Seattle, Washington. www.grahamdunn.com.

WHAT WOULD YOU DO?

Assume that you are the food and beverage (F&B) director at a full-service hotel in a large East Coast college town. Your general manager, Mr.

Peterson, is planning to have a large event centered on this year's Super Bowl. As the F&B director, you are an integral part of the event planning committee. One of the teams in the NFL final is from the state in which your hotel is located, so fan interest is very high.

Mr. Peterson proposes an event that will be held in the hotel's Grand Ballroom, which can hold 700 people. The festivities will begin at 3:00 P.M. on Super Bowl Sunday, with the televised pregame show, a darts tournament, and a Mexican food buffet. At 6:30 P.M., the game is to be shown on five 60-inch TV screens that will be placed around the ballroom. The chief maintenance engineer has assured Mr. Peterson that the sets can be mounted

on the ballroom's walls. The evening will conclude with a postgame "victory" party, which will end around midnight.

During one of the planning meetings, the discussion centers on the admission price that will be charged. The issue of reserved seating is raised by Scott Haner, director of sales and marketing. He believes that corporate clients of the hotel will be more inclined to attend if they can be assured good seats near the large-screen televisions.

1. As a hospitality professional, what issues must you consider prior to finalizing this Super Bowl party event?
2. If Mr. Peterson elects to charge a \$20 fee for seats close to the large screens, but only \$5 for seats farther away from the screens, would your opinion be different? Why or why not?
3. What are the responsibilities of the management team in this scenario?

THE HOSPITALITY INDUSTRY IN COURT

To understand just how possessive movie studios can be about their copyrights and how extensive the litigation can be in this area of the law, examine the following two case studies. First, consider *National Football League v. McBee & Bruno's, Inc.* 792 F.2d 726 (8th Cir. 1986).

FACTUAL SUMMARY

The National Football League and the St. Louis Cardinals (NFL) brought suit against McBee & Bruno's, Inc. (Bruno), owner of several St. Louis restaurants, for violations of federal copyright law when their restaurants broadcast the Cardinals' home games, which the NFL had "blacked out," or not broadcast within 75 miles of the Cardinals' home playing field.

The NFL maintains and manages contracts for all of its collective teams, including the Cardinals, with the major television networks. One clause of these network contracts specifies that any NFL games that are not sold out within 72 hours of game time will be blacked out of the broadcasting area.

All NFL games are telecast by the television networks in the following manner: television cameras present at the game capture the game play while announcers offer commentary from a sound booth. Then both the audio and the video signal are transmitted and combined together at an earth station outside of the stadium. The combined signal, or uplink, is sent to a satellite, which then transmits the signal, now a downlink, to a network control panel in Long Island. The downlink is termed a "clean feed" because it contains no images other than those broadcast from the stadium. After the downlink, the clean feed is sent to the television network studios, where commercials and other images are added, creating a "dirty feed." The dirty feed is retransmitted to the satellite and downlinked again to local broadcast stations, which add in local content and finally broadcast the game on the air.

Bruno owned sports bar restaurants within the 75-mile blackout area in St. Louis, and each sports bar had a satellite dish antenna that was capable of intercepting the clean feed downlinked from the satellite. Bruno, in fact, intercepted the clean feed and broadcast blacked-out games in all but two of its sports bars.

QUESTION FOR THE COURT

The issue for the court was whether Bruno's broadcast of the clean feed transmission was considered a violation of the Copyright Act, or if it qualified for the home-use exemption for transmitting copyrighted materials. The home-use exemption provides that "no copyright liability can be imposed for 'communication of a transmission embodying a performance by the public reception of the transmission on a single receiving apparatus of a kind commonly used in private homes.'" Bruno argued that satellite dishes fall within the exception because satellite dishes are commonly found within homes. Thus, the court had to determine how likely it was for the average patron watching a blacked-out Cardinals game at Bruno's to have the ability to watch the game at home.

DECISION

Ultimately, the court found in favor of the NFL because a District Court finding stated that, at the time, most satellite dishes were owned by commercial establishments, rather than families for home use, and those that were found in homes did not have the capability to intercept the satellite transmission clean feed. Thus, Bruno was found liable for copyright infringement from its pirated broadcast of the blacked-out games, because they could not find safe harbor under the home-use exception.

MESSAGE TO MANAGEMENT

Be aware that the contract rights of others can affect the management decisions of an unrelated hospitality venue. Just because your venue possesses a particular technological capability that is not available to the remainder of the public, as a manager, you should consult an attorney to determine the legal ramifications before using such technology.

Next consider the case of *Home Box Office, Inc. v. Pay TV of Greater New York, Inc.* 467 F. Supp. 525 (E.D.N.Y., 1979).

FACTUAL SUMMARY

In 1974, Home Box Office, Inc. (HBO) contracted with Microband National Systems, Inc. (Microband) to distribute HBO subscription television service to areas in and around New York City. HBO transmitted its service from atop the Empire State Building to various points throughout New York City. Microband received the signal with special equipment, converted the signal, and distributed it to individual households. Microband subcontracted the distribution service to other companies. Pay TV of Greater New York, Inc. (Pay TV) was one of those distribution companies.

Pay TV signed an agreement with Microband in October 1975 to distribute HBO services in Queens County for as long as Microband's contract continued with HBO. Pay TV claimed that it entered the agreement, believing it would eventually take the place of Microband as the main distributor. Pay TV repeatedly requested the right to distribute HBO services in other areas around New York City. HBO denied these requests, despite Pay TV's investment of money and effort in securing new service areas. In May 1976, Microband ended the agreement with HBO. HBO and Pay TV entered into negotiations for Pay TV to have exclusive distribution rights in the King and Bronx County areas as well as the already existing rights in Queens County.

By July 1976, no agreement was reached, but Pay TV continued to distribute services in Queens County and even expanded into other areas. In February 1977, HBO demanded in writing that Pay TV stop transmitting HBO service completely. A final attempt to reach an affiliation agreement failed, and in August 1978, HBO advised Pay TV it was transmitting HBO service without authorization ("pirating"). HBO advised

Pay TV the transmission was illegal, and if it did not stop, a lawsuit would be filed. HBO filed suit in December 1978. At the time of the lawsuit, Pay TV continued transmitting to over 8,000 customers, collecting \$75,000 per month. No payment was made to HBO by Pay TV. HBO asked for a temporary injunction to stop Pay TV from transmitting HBO service.

QUESTION FOR THE COURT

The question for the court was whether Pay TV could be ordered to stop intercepting and transmitting the HBO signal. HBO argued Pay TV was violating Section 605 of the Communications Act of 1934 (the act). Under Section 605, anyone intercepting and using signals not intended for the general public was violating the act. Pay TV admitted Section 605 applied to the suit between it and HBO, but argued that HBO consented to the interception of the signal. Pay TV also argued HBO waited too long to ask for an injunction. Finally, Pay TV argued that HBO was suffering harm for which money damages could compensate. With this argument, Pay TV could pay HBO damages but continue to transmit the service while the lawsuit was taking place.

DECISION

The court ruled Pay TV was pirating services and found no evidence that HBO consented to the illegal transmission. The court also held HBO was not too late in seeking an injunction, and money damages would not repair the harm being done by Pay TV. Pay TV was ordered to cease transmission.

MESSAGE TO MANAGEMENT

Pirating (or profiting from) broadcasts not meant for distribution to the general public (or without a license from the distributor, e.g., NFL) is illegal and can subject you to serious economic liability.

WHAT DID YOU LEARN IN THIS CHAPTER?

Property can be classified into several different categories. Real property refers to land and all the things attached to the land. Fixtures are personal items that were once separate but are now considered to be real property. Most items other than land are classified as personal property, which includes both tangible and intangible property. It is important to understand the difference among the categories of property, because different methods of financing the purchase of property exist for each category.

When property is transferred from one owner to another, specific types of documents and sales contracts are used to ensure the legality of the purchase and to protect the buyer and seller. Warranties, or advertised claims about the performance or quality of a product, are often treated as part of the sales contract. Thus, a seller is obligated by law to back up any warranties made. The Uniform Commercial Code offers protection under the law to both buyers and sellers of personal property, as well as to financial lenders.

A lease is a contract that transfers possession, but not ownership, of a piece of property. Leasing real and personal property is a common occurrence in the industry today. Whether a hospitality manager assumes the role of a lessor (landlord) or lessee, it is important to make sure that the lease agreement contains essential terms that will spell out the details of the agreement, and offers adequate protection to both parties.

Trademarks, patents, copyrights, and concept rights are all protected under the law. Hospitality operators must make sure that they are in compliance with laws governing the serving of brand-name products; the use or creation of concepts, logos, or images; and the public broadcasting of music and video.

After you have studied this chapter, you should be prepared to:

1. Restate the difference between real and personal property, and give five hospitality examples of each.
2. Secure a bill-of-sale form, and check it for the six critical information items listed in this chapter. List additional items on the bill of sale, and describe why you believe each is included.
3. Prepare a memo for your staff that lets them know the difference between a deed and a bill of sale. Include an explanation of when each would be used.
4. Secure a copy of an express warranty, and analyze it for differences with an implied warranty.
5. Using the Internet, locate a lender who finances hospitality operations. Determine the current interest rate for a \$1 million unsecured loan.
6. Choose a popular, independent, local restaurant. Write a two-page description of that property that you feel defines its trade dress.
7. Assume that your operation is considering whether to buy or lease a beer-dispensing system from your vendor. Your boss has asked you to prepare a memo addressing the legal aspects of the decision. Prepare a one-page memo that addresses the major issues.
8. Give a hospitality example of each of the following:
 - Trademark
 - Patent
 - Copyright
 - Trade dress

RAPID REVIEW

After reviewing Section 6.4 on leases, form teams of two, then pair up with another team. One team will represent the hotel; the other team will act as a potential tenant. Each team will have 15 minutes to review their position, after which 45 minutes will be used to negotiate the terms of a leasing agreement, using the following information:

- The space to be leased occupies 5,000 square feet in a hotel.
- The potential tenants are looking for a primary 10-year lease to open a restaurant/nightclub.
- Average rental rate in the area is \$10 per square foot for a three-year lease.
- The space is a shell only (walls, roof, dirt floor).

Make the best deal you can. Be sure to address the rental rate, finish-out allowance, lease term, and other issues raised in your reading and class discussions. If all issues are not resolved, discuss the terms of the last offer made.

TEAM ACTIVITY