On August 10, 2002, at the annual meeting in Washington, D.C., the Group H Committees of the Real Property, Probate and Trust Law Section held their annual Hot Topics program. There were 4 speakers – one representing each of the 4 committees – and the program was chaired and moderated by Rob Freedman of the Carlton Fields law firm in Tampa.

The first speaker was Susan Voss from Holland & Knight in Washington D.C., who spoke on behalf of the H-1 (Development, Operation and Management of Common Interest Communities) committee (Sandra Porter, chair, Gary Polikaoff, vice-chair). Susan provided the following summary of her comments:

Telemarketing
In response to a ground swell of complaints from the general public regarding telemarketing practices, 25 states have already passed do-not-call laws and several are pending. At the same time, in January 2002, the FTC issued proposed revisions to the Telemarketing Sales Rules, including a national do-not-call list. The FTC rule is more stringent than most state laws. In particular, there is no exemption for prior business relationships as there is in most state laws. The FTC rule does not pre-empt state law, a subject of considerable comment. Most commenters on the proposed rule felt that a national do-not-call list that does not pre-empt state law would be the worst of both worlds.

Real Estate Settlement Procedures Act (RESPA)
On July 29, 2002, HUD issued a proposed rule designed to simplify and improve the loan process and reduce settlement costs. There are three goals: improve the mortgage loan process; improve the Good Faith Estimate disclosures of closing costs that are given to borrowers; and provide a safe harbor from many of the disclosures for "guaranteed packages of settlement services" in which there is a set fee for all settlement services. Comments are due October 28.

Gramm Leach Bliley
Another area of general public concern has been privacy. The GLB became effective for most companies July 1, 2001. Essentially, it provides for privacy protections and disclosures for individuals borrowing for personal, family or household purposes. Originally thought to apply only to "financial institutions" such as banks and lenders, it soon became evident that it applies to any entity that provides loans and/or related services such as real estate settlement services, including developers, title companies, escrow agents, even law firms. Companies that are subject to the Act must give notices to all borrowers or individuals who provide them with "non public personal information" of the company's privacy policies and practices. The most difficult aspect of the law is that the Privacy Notice must be sent annually, as long as a relationship with the individual exists, even if the policies have not changed.

Anti-Terrorism Laws
A very recent development is the anti-terrorism laws, in particular, the Patriot Act and a series of executive orders issued by the President, the Treasury Department and the State Department. One purpose of these laws is to limit access to the considerable financial resources that are required to support terrorist groups. These laws apply to a broad variety of U.S. businesses. The Executive Orders prohibit doing business or providing donations of any kind to any person or entity on the list in the President's September 2001 Order, which has been revised several times. Under the Patriot Act all "financial institutions" must have anti-money laundering compliance programs in place by October 24 of this year. However, regulations for the type of financial institutions we have been discussing have still not been issued. Nevertheless, the programs must be in place by the October deadline.

The next speaker was David Dekker of the Thelen Reid & Priest law firm in Washington, who spoke on behalf of the H-2 (Sports, Entertainment, Gaming and Related Real Estate Issues) committee (George

Meyer, chair, Michael Laird, vice-chair). David spoke on insurance issues that may be of interest to real estate lawyers, and he provided the following summary of his comments:

> <u>Terrorism Coverage</u>.
> Before September 11, the property and casualty insurance markets were hardening, but the acts of that day greatly exacerbated the situation. Premiums have sky rocketed nearly across the board, and some coverages have dsappeared. A prime example is that many carriers are refusing to offer or renew terrorism coverage.
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> To address this specific problem, both houses of Congress have passed bills providing for the federal government to step in and pay a portion of terrorism losses if they reach certain designated monetary limits. The bills also impose some limitations upon the recoveries available in law suits arising out of terrorist acts. The purpose of these bills is to enable underwriters to estimate potential losses with greater certainty, which in turn should enable carriers to offer terrorism coverage. While there are significant differences between the House and Senate versions, the bills are in Conference Committee and passage is expected this year.
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> <u>Mold</u>.
> Mold daims have proliferated, and received wide media attention. A number of multi-million dollar verdicts have been reported. Under standard form commercial general liability policies in place until recently, there was some dispute whether mold claims were covered (principally under pollution and work exclusions), but insureds were generally able to obtain coverage. Property and casualty policies are now being endorsed with broad mold/fungus exclusions. Coverage is still available from some carriers, under traditional policy forms and/or specialty pollution forms, but it is expensive. This is a risk that all property owners, builders, contractors and others must consider how to address. It is also critical to implement procedures designed to promptly address water intrusion and other problems that could lead to mold growth.
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> <u>Additional Insured Status.</u>
> Many owners, builders, contractors and others rely upon their status as "additional insureds" under policies procured by others with whom they do business to cover a wide range of risks. The insurance industry has issued several forms designed to reduce the scope of coverage available to additional insureds. Under some recently issued forms, for example, additional insureds only have coverage for their vicarious liability for acts of the named insured. Under older forms (which are still available from many carriers), an additional insured's own negligence is also covered. Another example is that certain forms now limit coverage to ongoing operations of the named insured, excluding claims arising out of completed operations. Insurance professionals should pay close attention to this issue when negotiating contracts requiring additional insured status, reviewing certificates of insurance and considering the sources of insurance available, to ensure that as much coverage as anticipated has been procured.

The next speaker was George Kovac, a sole practitioner from Washington, who spoke on behalf of the H-3 (Hotels, Resorts and Tourism) committee (San San Lee and Irv Sandman, co-chairs, Matthew James Coe, vice-chair). George spoke on various hospitality-industry issues, and he provided the following summary of his comments:

> After decades in which branded hotel management companies largely dictated the operational and financial terms of management agreements, there has been a significant shift in negotiating the way services supplied to the hotel by the manager are sourced, priced and controlled. Hotel owners have become more aggressive and are attempting to permanently redefine their relationship with branded management companies. As revealed in pleadings, SEC filings and news reports, none of the major hotel companies has escaped this pressure. Three factors have converged to force vigorous debate on the

rules governing this relationship: changes in industry structure, the Woodley Road litigation and the peculiar nature of the current economic downturn.

First. In response to cataclysmic defaults in hotel loans in the early 1990's major hotel companies divested themselves of real estate ownership and its attendant debt. The brand name hotel companies defensively restructured themselves as management and licensing companies, largely isolated from the risks (and discipline) of real estate debt. The hotel companies presumed that the newly formed or spun-off real estate owning companies would remain friendly and largely passive investors, happy to serve the equity needs of the industry. In fact the real estate owning entities thrived. Many of the executives in the hotel ownership vehicles had backgrounds as real estate asset managers, who viewed hotel management companies as fungible service providers whose costs should be closely audited and controlled just like any other vendor. By the end of the decade, REITs and C-corps specializing in hotel ownership had matured in size, independence and sophistication sufficient to challenge the bargaining power of the management companies.

Second. The Woodley Park litigation filed in 1997, involving the management contract for a hotel in Washington DC, has encouraged real estate owners to challenge, under agency, fiduciary and fraud theories, the manner in which large management companies traditionally conducted business. While the utility of the Woodley Park cases in altering the governing legal principles is subject to debate, the case has greatly impacted the nature and vocabulary of negotiations throughout the industry. The plaintiffs asserted various contractual and fiduciary violations, particularly in the manager's handling of purchasing services and its retention of rebates and vendor concessions not shared with the owner. A jury awarded the owners $51 million dollars, of which nearly $38 million was punitive damages. In January of this year, the Delaware federal district court reduced the punitive portion of the award to $17.4 million. But in doing so, the court noted that the owner had established at trial that the manager "engaged in purchasing abuses, did not maintain adequate records of their purchasing program, took deliberate steps to conceal the details of their program and ultimately received over $30 million in 'rebates' over a six year period." *2660 Woodley Road Joint Venture, et al. v. ITT Sheraton Corporation, et al., 2002 U.S. Dist. LEXIS 439; 2002-1 Trade Cas. (CCH) P73,601 (D. Del.)* The Woodley Park case has emboldened owners and forced managers to rethink the transparency and appropriateness of their purchasing practices.

Third. The deep downturn in hotel business, which began three quarters before September 11, weakened both owners and managers but there is something very odd about this hotel recession. Unlike ten years ago, the real estate ownership side is in a much better position to assert its interests. A widely reported survey by PriceWaterhouseCoopers revealed some interesting facts. They predict that the delinquency rate on hotel real estate loans will peak at 5.5% of outstanding loans, well below the l6% levels seen in 1991-92. Several factors contribute to this relatively low delinquency rate: lower interest rates, better quality loans (as quantified by loan to value and debt coverage ratios) and effective cost cutting which permits hotels today to break even at 50% occupancy, as opposed to 65% in 1990. The practical implication is that most owners are strong enough to survive this recession, unlike the early 90's, when foreclosure often made owners irrelevant. Today's owners are the key players in working out troubled hotels. And the owners are not just looking to cut costs – that has already been done. They are looking to exercise greater oversight of their managers and are demanding a greater share of revenues from all sources related to the real estate asset.

Trends. Among the topics keenly under debate are:

o who owns customer databases, who has the right to market hotel services to these customer lists, who may sell customer information?

- who has the right to sell non-lodging services (such as high speed internet access and other information services) to hotel guests?
- what are reasonable territorial restrictions and rights to compete?
- who enjoys the benefits of volume purchasing discounts?
- who selects vendors and what is the permissible scope of profits resulting from transactions with purchasing entities affiliated with the manager?
- what are the standards for transparency in charging expenses to owners for marketing, advertising, frequent guest rewards?

In short, this recession will redefine which hotel assets are incidents of real estate ownership and which are incidents of the management business.

The final speaker was Toby Weas from the American Resort Development Association in Orlando, who spoke on behalf of the H-4 (Timesharing and Interval Uses) committee (Rob Freedman, chair, Bob Dady, vice-chair). Toby spoke on various timeshare-industry issues, and he provided the following summary of his comments:

There has been proposed the Americans with Disabilities Act ("ADA") Notification Act. This proposed legislation that not only affects the resort and timeshare industries, but all industries that must comply with the ADA. There was also discussion on the ongoing Federal telemarketing and "Do-Not-Call" (DNC) issues. The FTC is working on a possible national DNC list – similar to what about half of the states currently have in place. I outlined the timeshare industry's new positive relationship with the FTC and the ongoing working relationship we have with them on the telemarketing issues.

At the state level, several issues were discussed. Probably the most important ongoing timeshare issue at this level is taxation: including real property taxes, personal property taxes and, in some places, sales taxes. On the real property front, I discussed in some detail the complex issues surrounding the different ways a timeshare unit may be subject to taxation. Many factors affect how a timeshare may be taxed, including the following: existing state laws (in the timeshare act too, if applicable), understanding of the industry by the assessor and any local "traditions," whether the timeshare is deeded, non-deeded, points based, trust based, co-op base, or based upon a right-to-use license, or some combination thereof, etc. Unfortunately, there is much misunderstanding of the timeshare industry that often leads to it being a "target" for increased taxation. Additionally, personal property and sales tax issues can arise in certain jurisdictions.

Non-tax issues that were discussed include personal property timesharing (e.g., "timeshared" cruise ships, motor homes, house boats. . .), marketing issues (including owner referral programs that are often misunderstood by local realtors), multi-state uniformity issues (disclosures, consumer protections, etc.) and advertising issues.

Another issue that I discussed was fractionals (sometimes referred to as "fractional ownership" or "residence clubs"). We discussed exactly what constitutes a fractional and the different legal structures utilized by fractional developers. Also, we discussed issues surrounding whether or not fractionals actually are timeshare or "something" different. Should fractionals be governed by timeshare laws or should there be some sort of "sophisticated purchaser" exemption based upon an admittedly arbitrary purchase price cutoff?

Several other random issues were discussed. We discussed the resiliency of the timeshare industry after the tragedies of 9-11. The timeshare market proved to be somewhat recession and disaster proof. Owner often shifted their vacation plans (e.g., by going to a "drive-to" resort), but they did travel in the months after 911 in much greater numbers than most other segments of the tourism industry. We also briefly

discussed the continuous growth of the timeshare industry and that it is *slowly* becoming more of a sought good, rather than a sold good. Additionally, the public perception of timeshare has increasingly become positive.