# CASE STUDY OF A TROUBLED HOTEL LOAN:

# THE HEAVENLY GARDENS HOTEL

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As a focal point to discuss troubled hotel loans, the following case study demonstrates many problems that can befall a hotel loan. This case study is a caricature. Any real hotel that suffered from this many problems would probably long ago have undergone some cataclysmic event. For discussion, though, the more problems the merrier. Each can be discussed separately (as if it were the only problem, and the others did not exist) where appropriate. The reader should not assume any panelist believes any project could have as many problems as this one, or that anything in this case study demonstrates sound practices for hotel investments, legal work, due diligence, financing, or marketing. All names, descriptions, background, and other elements of this case study are fictitious. Any similarity to actual people or entities is unintentional. Any opinions expressed or implied are those of the author only, and only at the moment of writing. The author reserves the right to express or imply any other opinion at any time.

## 1. THE DEADMAN'S LOAN PORTFOLIO: DUE DILIGENCE AND ACQUISITION

Deadman's Life Insurance Company ("Deadman's") was, until recently, considered the leading hospitality lender in the United States. Any hotel developer, investor, or other owner knew that when other lenders said no, Deadman's would often say yes, and with enthusiasm and often more loan proceeds than the borrower ever expected.

As a result, Deadman's accumulated a portfolio of hotel loans from coast to coast, at rates up to 200 basis points over "plain vanilla" commercial mortgages. When Deadman's decided to exit hospitality finance, its portfolio of 73 hospitality loans attracted dozens of bidders.

To sell its portfolio, Deadman's gave each bidder a CD-Rom with copies of all 73 loan files. Each loan file was scanned as a single "PDF" file, with names ranging from "Scan001" all the way to "Scan073." To look at any loan, all a bidder needed to do was open the PDF file for that loan file and scroll down through the file until they found whatever they wanted to look at. If a purchaser wanted to review the title policy, all they needed to do was scroll through 572 pages of loan agreement, mortgage, assignment of rents and leases, management agreement, and so on, until they finally got to the title policy. No problem. This was the 21st Century. Deadman's took great pride in its use of CD-Roms to replace physical "data rooms."

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One bidder, a "usual suspect" in any portfolio sale of this type, was Julia Hotel Finance, LLC ("Julia"), an "opportunity investor" specializing in hotels. Julia ordered the Deadman's CD-Rom and started its due diligence review of the loan files.

At one point early in its history, Julia had conducted very thorough due diligence for its loan portfolio purchases. Julia paid its attorneys to fill out a 40-page form, asking an incredible range of questions about each loan. For the yield maintenance formula, what was the exact definition of "Treasury Rate"? How much prior notice of cancellation was the insurance carrier supposed to give? Did the "Mortgaged Property" include tenements and hereditaments? Did state law allow for nonjudicial sale of the collateral? Did the file contain a statement of sources and uses? Did the file contain a separate further assurances agreement? When and where was each UCC-1 filed? Did the mortgage allow the lender to accelerate if a change in real estate taxation required the lender to pay a share of the real estate taxes (a so-called "Brundage Clause")? Did the assignment of contracts and permits include an attorneys' fees clause? Did the mortgage allow the lender to recover paralegal fees as well as attorneys' fees? What was the name and contact information for the individual lawyer who closed the loan? Did the mortgage expressly require the borrower to maintain the roof? Did the appraisal include current color photographs of the site and a resume of each appraiser? And so on and on and on.

Julia's 40-page loan review form meant that for every portfolio acquisition, Julia mobilized a large team of accountants, lawyers, paralegals, typists, and proofreaders who would work 24 hours a day in shifts for up to a month, generating piles of file boxes full of loan report forms and related exhibits, never finished quickly enough to meet Julia's aggressive closing schedule.

After purchasing its first dozen or so loan portfolios, Julia realized that no one ever looked at these loan report forms. Most data items affected neither pricing nor loan administration. Although whoever initially created the 40-page due diligence form surely had a good reason to ask each question, the sole practical function of all these questions was to incur due diligence expenses that Julia decided were intolerable. By the time of the Deadman's transaction, Julia had moved to the other extreme.

For Deadman's, Julia engaged Wall Yoo Waite LLP ("WYW"), a law firm that specialized in massive but quick due diligence projects for loan portfolios. Through a "request for proposals" process, Julia reduced its legal due diligence costs to a low three digits per loan. For this fixed fee, WYW agreed to check that the basic documents, including the original signed note, were in the file, confirm the loan amount, review title information, and type up a one-page due diligence summary form. Through the same RFP process, WYW agreed that if Julia did not close on the portfolio, WYW would waive half its fee.

WYW distributed copies of the Deadman's CD-Rom to the due diligence team, finished its review of the 73 files on schedule, and gave Julia a "clean" ("no problems found") one-page due diligence form for each file. Julia submitted the winning bid, 93 cents on the dollar of outstanding principal. Julia closed and WYW didn't have to discount its fee.

For a portfolio that cost around a quarter billion dollars, Julia took great pride that it had been able to limit total legal due diligence costs to just under a basis point on the purchase price. Julia paid only a fraction of that amount for all contract negotiations and the entire closing.

The president of Julia had been quoted many times in the industry press as saying her favorite participatory sports were foxhunting and getting lawyers to do more work for less money. With this transaction, she had won the game again.

Julia assigned about 20 of the Deadman's loans to a junior asset manager, Gloria Malkin.

## 2. PRELIMINARY OVERVIEW OF THE LOAN

One of Malkin's loans, with a principal balance of $3,500,000, was secured by a 150-room limited service hotel – the Wurst Eastern® Heavenly Gardens Hotel – in Central Metropolis, East Carolina. The name of the hotel referred to the "Wurst Eastern" franchise brand name and to the nearby Heavenly Gardens Cemetery, the largest tourist attraction in this part of East Carolina. The hotel was owned by Heavenly Gardens, L.L.C.

The file was perfect and complete. WYW had checked off every item on the due diligence checklist: loan agreement; original promissory note; copies of filed UCC-1's. Everything had been done right. Not a single problem with the file. Great paperwork. And Julia's abbreviated loan review checklist showed a column of little boxes all checked "yes" or "no problem found."

According to the loan file, Heavenly Gardens was built in 1972, then operated for well over a decade without a brand name or third-party management. In 1989, the same year Deadman's originated this loan, the hotel was flagged under a then-leading brand name and the same company was engaged as manager. In 1995, that franchisor/manager established its new "Wurst Eastern" brand name and this hotel joined the new brand. At the same time, the 1989 management agreement was assigned to Wurst Eastern Management Corporation.

The loan was restructured in 1992 with entirely new loan documents.

In their file review, the WYW lawyers had checked "yes" where the due diligence form asked if a "franchisor comfort letter" was in place, and whether the file contained a copy of the management agreement.

Malkin noted that the payments on the Heavenly Gardens loan were current and had been since the 1992 restructuring. The tracking sheet in the file indicated that Deadman's had been receiving quarterly and annual financial reports as required, though she could not find them in the file. The correspondence file indicated no sign of trouble. So she routinely set up the loan on Julia's computer system and paid little more mind to it for about six months.

Then everything changed. She received a fax from Joseph Patell, a hotel investor whose name she had seen before but in a context she could not remember. Patell informed her that he had recently obtained control of Heavenly Gardens, L.L.C. and the hotel, and had some new concepts for it and wanted to meet with her as soon as possible in her office to discuss the role that Julia could play in the new and improved Heavenly Gardens Hotel.

They scheduled a meeting for two weeks later. During those two weeks, Malkin hired new counsel to look through the document file for the loan, and otherwise try to better understand Julia's position regarding the Heavenly Gardens hotel.

## 3. WHAT THE FILE SHOWED

Here is a summary of what Malkin and her new counsel found when they reviewed the file more thoroughly than had been possible during the original due diligence.

3.1. *Management Agreement*. Wurst Eastern Management Corporation had the right to manage the hotel – and rights of "quiet enjoyment" and "unimpeded possession" of the hotel – through 2016, with three ten-year renewal options. These options required 60 days prior notice of exercise, but otherwise had no conditions at all, except that the management agreement had not been terminated.

The owner could terminate the management agreement at any time by paying Wurst Eastern an amount equal to six times the annual fee paid during the richest year of the preceding five at the time of termination. This right was, however, "personal" to Heavenly Gardens, L.L.C. It could not be exercised by any successor or assign, "including without limitation any party acquiring title through foreclosure or deed in lieu of foreclosure."

The management agreement stated that it could not be recorded. Whoever negotiated it had gone out of their way to write in large capital letters across the top of the first page: "THIS AGREEMENT MAY NOT BE RECORDED. ALL RECORDING OFFICERS ARE DIRECTED NOT TO RECORD THIS AGREEMENT."

The management agreement said that if the hotel ever lost its Wurst Eastern franchise license, then Wurst Eastern could close the doors and suspend hotel operations until the license was reinstated.

The management fee was 5.5% of "gross revenue," a figure that was very broadly defined to include even imputed revenue based on the value of bartered rooms, "comp" rooms, and rooms used for Wurst Eastern's "frequent guest" program. This imputed revenue had risen significantly during the preceding three years. It was nearing 20% of the hotel's gross revenue. Wurst Eastern received no "incentive fee."

Wurst Eastern was to apply 3% of gross revenue as a furnishings, fixtures and equipment reserve fund, and 1% as a capital improvements reserve fund. Both would be held in the name of Wurst Eastern and could be maintained as part of its master cash control, management, and protection system.

The hotel was required to participate in all systemwide procurement and servicing arrangements that Wurst Eastern set up, including any systemwide contracts established with Wurst Eastern affiliates for any hotel-related services, provided they were entered into on reasonable and competitive terms. At the time the management agreement was signed, the closing binder indicated that the parties had signed an insurance services agreement, a purchasing agreement, and (although the hotel had no restaurant at the time of the original closing) an agreement that somehow related to "kitchens." Copies were not in the file.

Malkin remembered reading in the industry press that Wurst Eastern had recently set up an internet service provider affiliate, a telephone company, a room service pizza delivery affiliate, and a concierge services subsidiary. The same article reported that Wurst Eastern had told stock analysts that Wurst Eastern was exploring more subsidiaries to operate the front desk, the laundry room, and housekeeping services, but these would come in future years. Each Wurst Eastern affiliate would provide services to all hotel rooms in the Wurst Eastern system.

Wurst Eastern was setting up these subsidiaries to streamline and modernize every major hotel function, "for the benefit of all its stakeholders" and to even out "undesirably volatile" peaks and valleys in Wurst Eastern's earnings. This would let Wurst Eastern take a longer-term view of its relationship with its franchisees and give its franchisees the long-term benefit of a more stable brand. Wurst Eastern would no longer need to be distracted from its central mission by having to deal with "freakish" shifts in quarterly earnings.

The management agreement didn't obligate Wurst Eastern to report to the owner, let alone the lender, regarding the existence and terms of any contracts already in place – or future contracts -- with Wurst Eastern's affiliates.

3.2. *Lockbox Agreement*. The closing documents for the 1992 restructuring contemplated that a lockbox agreement would be in place for the Heavenly Gardens hotel. But the lockbox agreement was not signed. Instead, the parties had handwritten across the top of the first page, and initialed, the following statement: "To be resolved within 30 days after closing." Nothing in the file suggested the lockbox arrangements had ever been resolved. Wurst Eastern, as manager, had presumably been collecting all cash from operations and remitting to the owner periodically in accordance with the management agreement. From those receipts, the owner had been paying the loan on time for about five years. No harm, no foul.

3.3. *Nondisturbance Agreement*. The file included a copy of a recorded agreement between Deadman's and the original manager of the hotel, in which Deadman's agreed, in the event of foreclosure, not to disturb the manager's unimpeded and exclusive possession of the hotel so long as the manager was not in default beyond applicable cure periods. The management agreement was defined as the original management agreement, as it may be amended in good faith from time to time by Wurst Eastern and the borrower, whether or not such amendment were recorded. The agreement said little more. It was Deadman's standard form of anchor store SNDA, marked by hand to replace the name of a now-bankrupt chain store with the name of the original hotel manager.

3.4. *Licensor Comfort Letter*. When Wurst Eastern had taken over management in 1995, Wurst Eastern had issued a new "licensor comfort letter" to Deadman's, in which Wurst Eastern said it "absolutely, unconditionally, and irrevocably commits and agrees" that before taking any action to terminate the hotel's Wurst Eastern license, it would notify the lender and allow the lender 30 days to cure the default. Absent such notice, and "notwithstanding any dispute or claim between Owner and Licensor," Wurst Eastern would never do anything to interfere with or impair the continued effectiveness of the Wurst Eastern franchise license.

3.5. *Lender-Manager Relations, Generally*. Nothing in the assignment documents from Deadman's to Julia indicated that Deadman's had ever assigned to Julia the nondisturbance

agreement or the licensor comfort letter, or that either lender had ever notified Wurst Eastern that Julia had bought the loan. This may have been outside the scope of WYW's services.

3.6. *The Loan Documents*. The promissory note, recorded mortgage, loan agreement, recorded assignment of rents and leases, security agreement, filed UCC-1 financing statements, and all other closing documents were all in the file. All had been signed for the borrower by someone other than Joseph Patell, whose name actually showed up nowhere in the closing sets.

The loan bore interest at 7.5%. The current balance of about $3,500,000 reflected some amortization, based on occasional paydowns from excess cash flow, but mandatory amortization requirements were quite modest. The loan would mature in 2004.

The loan documents did not seem extensively negotiated – except the nonrecourse carveouts. These had been so extensively negotiated that some final changes had been marked by hand and initialled. The borrower had assumed unconditional full personal liability for a wide range of bad acts. For even the slightest misapplication of cash, the borrower would become personally liable for 250% of the cash misapplied. The entire nonrecourse clause would fall away, and the borrower would become personally liable for every penny of the loan, if the borrower ever lifted a finger to interfere with a foreclosure action or other exercise of remedies. The nonrecourse clause was a work of art.

The mortgage prohibited the borrower from transferring the hotel without the lender's consent, but said nothing about transfers of equity within the borrower. If the borrower were to convey the hotel without the lender's written consent, this would have triggered a nonrecourse carveout and full personal liability for the borrower.

Between the "counterparts" clause and the clause on "successors and assigns," the loan agreement had a short paragraph that mentioned a letter of credit for $500,000 held by Deadman's, but the file mentioned it nowhere else.

3.7. *UCC Search*. Julia's new counsel ordered a UCC search against Heavenly Gardens, L.L.C., and it showed the following.

- *Original Filings*. All UCC's had been filed correctly. All had been continued in the name of Deadman's.
- *Equipment Lessors*. Various equipment lessors had filed UCC's against particular assets and, in one case, "all personal property, including without limitation all income and revenues, of Heavenly Food Corp.," an entity that was mentioned nowhere in the closing binders.
- *Liens on Membership Interests*. A couple of years before, Heavenly Gardens, L.L.C., had signed UCC's in favor of Patell Enterprises, Inc., identifying as collateral all the membership interests in the borrower.
- *Lien on Everything*. At about the same time, the borrower had signed more UCC's in favor of Patell Enterprises, Inc., with a collateral description that appeared to have been scanned in from the Deadman's UCC filings from the

original closing. All the Patell filings had been filed in all the correct offices and had not expired.

Malkin met with her new counsel to go over the file. She asked these questions:

- *Deficiencies.* This file seems rather deficient in some ways. What are the main problems with the file? Which should I care about? Why?
- *Patell.* Who is Patell and what is his role in the borrower and should I care?
- *Patell's Agenda.* What is Patell likely to want during the meeting? How should I respond to it?
- *Strategy.* What, if anything, do you recommend I do now to improve our position regarding collateral and any upcoming negotiations?
- *Due Diligence.* Do you recommend any further due diligence or investigation?

She met with counsel for several hours to discuss the answers to those questions, but the notes from that discussion are lost. Malkin has now requested some help in reconstructing what was said.

Whatever was said, Malkin thought it made sense to meet with Patell.

## 4. THE FIRST MEETING

Joe Patell arrived, an hour late, with his chief financial officer and his chief of quality control. Each carried a thick binder labelled in large letters: "HGH: Rescue Plan."

At this first meeting, Malkin saw her role as primarily one of listening, seeing what Patell had to say and what, if anything, he wanted her to do. "I'm just conducting a listening tour," she said.

The chief financial officer began by going over some of the numbers. He reminded Malkin that the hotel had been carrying its debt service without a problem since 1993. Occupancy and rates were volatile from month to month and year to year, with no particular trend or pattern, except for a significant downturn while the Heavenly Gardens cemetery had been closed for renovation.

According to Wurst Eastern's monthly statements, the hotel's reserves were amply funded. The last major capital program for the hotel was undertaken in 1989, when Wurst Eastern's predecessor as manager of the hotel had taken over. At that time, the hotel had invested substantially in ironing boards, coffee machines, toaster ovens, new drapes, imported artwork, and potted plants in every room. Since then, the hotel had made no capital upgrades or capital replacements.

Patell spoke next. He explained that he had acquired some complicated interest in the ownership structure of the hotel that didn't even require notice to the lender, let alone consent ("a

long story," he said). He assured Malkin that his participation would be a good thing. He had in mind only what was best for the hotel and everyone involved in it, including the lender.

The hotel, he said, now faced some challenges, not all of them obvious or otherwise known to the lender. Patell's chief of quality control described the following problems.

- *Management Fee Deferral.* For about a year (ending 18 months ago), the Heavenly Gardens Cemetery had been closed for renovation, which reduced occupancy rates by about ten percentage points. To relieve stress, Wurst Eastern and the hotel owner had amended the management agreement to temporarily defer half of Wurst Eastern's management fee. The deferred management fee would bear interest at 18% per annum and was repayable solely from certain excess cash flow or if the management agreement or the Wurst Eastern license were ever terminated. In the latter case, the manager could apply any owner funds within its control toward repayment of the loan. The balance of the deferred management fee, with interest plus a substantial "deferral fee," was now about $122,000.

- *Nearby Rezoning.* Four sites within a mile of the hotel had recently been rezoned for limited-service lodging – exactly the market in which Heavenly Gardens operated. The rezoning had been proposed by one of East Carolina's most active budget hotel developers, and actively supported by "Metropolis NOW!," a group that Patell suspected was financed by the competing developer. To try to stop the rezoning, Patell had formed and bankrolled the Council to Preserve Central Metropolis. The Council had filed a half dozen lawsuits in state and federal court, alleging claims under state and federal environmental, historic preservation, endangered species, landmarks, zoning, and other statutes. But the Council lost on all counts. Patell's trial counsel had assured him in a 12-page letter that the lower court ruling was "nothing to be concerned about at all," as there were at least ten excellent arguments for overturning it on appeal. The deadline to file a notice of appeal would run in about 60 days. Appellate counsel wanted a deposit of $45,000 to file the notice and start the brief.

- *Short-Term Development Plans.* The other developer had filed plans to build two branded hotels that would compete directly with Heavenly Gardens. According to the rumor mill, the first hotel would be a "Wurst Eastern Family Deluxe Express Suites and Gardens" hotel, Wurst Eastern's latest new concept, which replaced its previous, more upmarket, "Wurst Eastern Golden Regal Deluxe Suites."

- *Reinspection.* Prompted perhaps by the excitement over rezoning, the municipal government had re-inspected the hotel and sent Patell a violation notice. The violation notice was the upshot of the following sad sequence of events. Because the hotel's application for a permanent certificate of occupancy (a "PCO") had been filed on the wrong color of paper, it had been processed by the electrical division, not the C of O division. It was permanently filed in the electrical file, and could not be used for PCO purposes. Therefore the hotel had never qualified for a PCO. Patell said he had applied for a retroactive PCO despite the glitch, but the buildings department rejected the application: "If we did it for you, we'd have

to do it for everyone," the department chief told him. Without a PCO, the hotel remained subject to building code changes since the last temporary certificate of occupancy about 15 years earlier. As a result, the hotel was now required to expand all the bathrooms and widen all the doorways on both the first and second floors, to accommodate guests in wheelchairs. (The hotel already had seven ground-floor "disabled" units. Disabled guests had rented these units for 53 nights in the last five years – just under one room night a month.) The buildings department had also determined that the walls between the guest rooms in the hotel didn't go high enough. They stopped a few inches above the ceilings of each guest room, but should have been built all the way up to the prefabricated concrete slab another three inches above, to satisfy new code requirements. This would require repairs in the ceiling of every guest room. Except for these minor details affecting all the guest room doorways, all the bathrooms, and all the walls between all the guest rooms, the hotel was in great physical shape.

- *Franchise Termination.* As a result of these problems, a missed payment of deferred management fee, chronically low quality control scores, and recent vice squad activity at the hotel, Wurst Eastern had notified Patell that Wurst Eastern was terminating the license for the hotel, effective in four days. This was actually the third termination notice Patell had received. It said Wurst Eastern's quality control personnel would arrive with cranes to remove all Wurst Eastern signage at the hotel at 12:01 a.m. on the effective date of license termination. The hotel had already been removed from the Wurst Eastern reservations system. This was all news to Malkin.

## 5. PATELL'S PLAN

Although Patell and his team acknowledged that the hotel had a number of problems, they told Malkin that they had a plan to solve everything, totally reposition the hotel, and beat the much stronger competition likely in the future. But the plan would cost money, and Patell wanted Julia to advance that money to get the job done. His proposal:

- *A New "Draw."* In Patell's opinion, the hotel needed a new "draw." He wanted to build an aquarium, partially underground, on some vacant land abutting the hotel. He projected that an aquarium would draw hundreds of visitors a day. At least half of these would stay in the hotel, which could then raise its rates and pay for the aquarium, all the necessary capital improvements, and then some. The aquarium would be operated on an arm's length basis by an aquarium management company that Patell owned, producing extra rental income for the hotel in the form of percentage rent.

- *Artwork.* Patell had found an artist who would create and install a huge mosaic about fish, covering the floors and walls in much of the public area of the hotel and the new aquarium. The artist was willing to work for free for the prestige of being identified with the new aquarium and the new and improved hotel.

- *Capital Work.* Patell said he was inclined to bite the bullet and do the work necessary for a PCO. He would turn the problem into an opportunity by using it as a chance to upgrade some finishes, clean up and replace some damaged walls and other parts of the building, and generally upgrade the physical plant, though not above a "limited service" standard.

- *The Numbers.* The improvements in the hotel, and the new aquarium, would support a substantial increase in room rates and occupancy, even after allowing for incremental costs. The "Rescue Plan" binder included the following tables to summarize how the proposal would affect capital structure and income.

| | SECURED DEBT | VALUE |
|---|---|---|
| **Existing Hotel (70% LTV)** | $3,500,000 | $5,000,000 |
| Proposed Capital Repairs (Including Some "Deferred Maintenance") | +750,000 | +600,000 |
| Proposed Aquarium | +1,000,000 | +2,000,000 |
| **Repositioned Hotel (69% LTV)** | $5,250,000 | $7,600,000 |

| | EXISTING | AFTER LOAN INCREASE |
|---|---|---|
| Gross Hotel Revenue | $1,900,000 | $2,500,000 |
| (Management Fee = 5.5% of Gross) | ($104,500) | ($137,500) |
| (FF&E Reserve = 3% of Gross) | ($57,000) | ($75,000) |
| (Cap. Imp. Reserve = 1% of Gross) | ($19,000) | ($25,000) |
| (Other Operating Expenses) | ($1,300,000) | ($1,275,000) |
| Percentage Rent from Aquarium | | $125,000 |
| Operating Income | $419,000 | $1,112,500 |
| Interest-Only at 7.5%/annum | ($262,500) | ($393,750) |
| Amortization | 0 | 0 |
| Real Estate Taxes | ($100,000) | ($160,000) |
| Net Profit | $57,000 | $558,750 |

- *Possible Sale.* An out-of-town developer, Gilbert Glitz, had asked about buying the hotel, but only if the aquarium were completed and opened to the public. Glitz's plan for the hotel/aquarium was to install highly polished brass finishes on all visible surfaces, interior and exterior, and aim for a much more sophisticated and upscale clientele. He would rename the facility "Aqua-Glitz." Glitz had said he might pay $10,000,000 for the hotel/aquarium.

## 6. MORE BACKGROUND AND QUESTIONS

Malkin thanked Patell and his team for taking the time to meet with her, and promised she would consider their proposal. She has requested your advice on how to respond. By way of further background and for further discussion, she added the following thoughts and questions:

- *Construction Lending.* Julia prefers to avoid construction lending, but has done it.

- *Property Management.* Julia has a property management division that could operate this hotel and provide a brand name on an interim or longer basis. This is part of what Julia does.

- *Loan Purchase Offer.* Wurst Eastern recently offered to buy the loan for 63.5 cents on the dollar – a figure far below the selling price necessary for Julia to achieve its targeted internal rate of return on the asset.

- *Lost Flag.* If the hotel could not operate as a "Wurst Eastern," it would probably lose half its reservations and see its average daily rate drop by 20%. Initiation of a new brand name could cost over $100,000. To deal with the problem, Julia's staff would run up several hundred person-hours of time at an effective rate of almost $100 an hour. Malkin asked whether she could recover these costs from Wurst Eastern because Wurst Eastern terminated the license without notifying the lender. More generally, Malkin asked whether Julia has a good claim against Wurst Eastern and how much Julia should expect to recover.

- *Accounting.* In the current quarter, Julia has already suffered more losses than it wants to show. Julia must defer recognition of any further losses.

- *The Glitz Connection.* Malkin saw in her college alumni magazine that an old classmate now works in Gilbert Glitz's company. Malkin called him. He told Malkin that Glitz was seriously interested in the hotel. He suggested that Malkin simply foreclose – pick up the hotel for the loan balance – then resell it to Glitz. Glitz might even be willing to bid the full loan amount at the foreclosure sale, he said, with a separate payment to Julia to facilitate the sale and to assure that Glitz got the property at a good price without interference from other bidders.

- *Aquariums.* For three fee-owned hotels, Julia's development arm had achieved great results by acquiring adjacent land and building an aquarium. The United States is dramatically "under-aquariumed." Fish viewing is a growing hobby in secondary and tertiary cities. Studies show these hobbyists will often drive up to 200 miles for a good aquarium.

- *What's Missing?* Malkin thinks that maybe Julia should take other measures to investigate and deal with the Patell situation. What would you suggest?

- *Sue the Lawyers?* Should Julia sue Wall Yoo Waite LLP, the law firm that gave the loan file a clean bill of health? Should Julia win?

- *Malkin's Career.* On a personal note, Malkin plans to leave Julia's asset management department and move into originations. She asked whether she can learn anything from this file that might help in her new position.

What do you tell her?