

## **HILTON REALITIES EXPOSED BY NIHAL !**

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I refer to the lead story in the *DailyFT* of December 19, 2011 under the headline "Thiru trims Hilton !". With no undermining of the efforts of or offence to Thiru Nadesan, I am compelled to disclose the salient facts, since such publication, ought not camouflage and draw a 'smoke screen', as an endeavor to justify the hasty and secretive enactment of perverse legislation, the constitutional validity of which, I have put in issue before the Supreme Court, which has ordered the issuance of Notices on the Respondents. Copies of relevant documents have been forwarded in proof of these facts.

When Hilton Hotel was originally mooted, the management agreement entered into on January 19, 1980 had provided for management fees of 25% of gross operating profit (GOP), after providing for refurbishment, and before charging rates and taxes on the property and long-term loan interest. Management fees prevalent in the hotel industry then was 3% of the turn-over with 15% of GOP, or 4% of turn-over with 12% of GOP, or 5% of turn-over with 10% of GOP. Hilton management agreement was reconfirmed by a new management agreement entered into on January 31, 1984, with the Government becoming a party to the project.

After Hilton Hotel was restored, consequent to the damage caused by the bomb explosion in 1997, it was discovered that Hilton International was charging group services and benefits, including regional office and central marketing expenses, which exceeded the 25% management fee on gross operating profit, as defined. It was discovered that charges made by Hilton International had ranged from 31.2% to 34.9% in the years 2001 and 2004. In these circumstances, then Chairman HDL, Ajith Dias, in 2003 sought the assistance of specialist UK Consultants, PK International Hotel Property Services to troubleshoot. Further, it was discovered that Hilton Hotel was not achieving the expected GOP of over 40% (expected to be 42% - 45%), giving rise also to questions on average room rates and occupancy, which were relevant factors.

Consequently, the following heads of terms of a proposed management agreement was reached, which comprised - management fees of 2% of revenue + incentive fees of 7% of the adjusted GOP (AGOP), with rates and insurance also deducted, if AGOP exceeds Rs. 400 Mn., to be increased with an annual indexation, and 2% of revenue in respect of group services and benefits. 4% of turn-over would amount to 10% of GOP, where the GOP is 40%. The refurbishment provision was to be 5% of revenue.

The initial term was 10 years, with option to extend for 2 further 5 year periods, upon mutual agreement; with provision for termination, if the Hotel's 'RevPar' (a combination of average occupancy and room rates) in 2 consecutive years does not exceed its competitors. Hilton was not to operate another Hotel within the Municipal limits of Colombo, excluding the existing Hilton Residency. Hilton expressed interest to develop a 350 room luxury resort in the east-coast or the south-coast for which it sought a suitable and acceptable site from the Government, which was a separate matter. As per the heads of terms, an agreement was drawn up to be signed, subject to Hilton International's corporate approval and Government's approval.

Thereafter, a Cabinet Appointed Negotiating Committee (CANC) appointed to restructure HDL, included the above heads of agreement with Hilton International in their Report dated July 11, 2005, submitted to the Cabinet, and subsequently approved by the Cabinet on October 13, 2005, as per Cabinet Memorandum of October 5, 2005. I resigned as Chairman HDL on November 10, 2005.

Since HDL failed to be restructured, as had been proposed by the CANC, as per the alternative option approved by the Cabinet, I filed on November 17, 2006 the winding-up application DC Colombo Case No. 217/CO to wind-up HDL, in which eventuality, Hilton International would have had to enter into a management agreement with a new company, which as a consequence, would have evolved.

There was a bomb explosion in October 1997, whereby several buildings in the City, including Hilton Hotel, were extensively damaged. Consequently, under a 'business interruption insurance policy', Hilton International negotiated a payment of US \$ 10 Mn., from the overseas insurers for the re-instatement of the Hilton Hotel. By Letter dated January 16, 1998, Hilton International claimed title to such insurance monies of US \$ 10 Mn., paid to HDL for the re-instatement of the Hotel. On such hypothesis, Hilton International required additional new Shares of HDL to the value of US \$ 7 Mn., to be allotted to Hilton International, and the balance US \$ 3 Mn., to be re-paid over 30 months, as an increase in the subsequent insurance *premia*, to the Insurer.

I refuted such stance of Hilton International, by my Memo dated 28.3.1998 to the HDL Board, with copies, among others, to Deputy Secretary to the Treasury, P.B. Jayasundera. I successfully established, that such insurance monies of US \$ 10 Mn., paid to HDL, rightfully and lawfully, belonged to HDL, and not to Hilton International.

Had it not been for such defiant stance, the US Dollar at that time being equivalent to SL Rs. 61/-, for an amount of US \$ 7 Mn., Hilton International would have got additional new Shares of HDL to the value of Rs. 427 Mn., against the nominal Share Capital of HDL of Rs. 452.3 Mn., thereby increasing the nominal Share Capital of HDL to Rs. 879.3 Mn. Had Hilton International been given additional new Shares, as had been required, to the value of 427 Mn., this would have vested in Hilton International, an ownership of 48.5% of the increased new nominal Share Capital of HDL.

The foregoing endeavour by Hilton International to acquire a 48.5% of the increased new nominal Share Capital of HDL, together with the Shareholdings of the Japanese, as a consequence reduced to 14.2%, would have given a total 'controlling' Shareholding of 62.7% in HDL to Hilton International and the Japanese, compared with Government's Shareholding being reduced to 33.4% ! This was successfully averted.

As at March 31, 2006, HDL's accumulated losses stood at Rs. 5,994 Mn., with a deficit of Rs. 5,323 Mn. Long-term loans stood at Rs. 8,067 Mn. The Winding-up Application, DC Colombo Case No. 217/CO was instituted by me on November 17, 2006, which was opposed by the HDL Board, controlled by the Government. This was in blatant and flagrant violation of the provisions of the Companies Act No. 7 of 2007, which in the given facts and circumstances statutorily mandated winding-up of HDL.

Consequently, as at March 31, 2010, the accumulated losses of HDL had increased to Rs. 10,302 Mn., with a deficit of Rs. 4,773 Mn., even after having revalued the fixed assets. The long-term loans had increased to Rs. 11,725 Mn. By March 31, 2011 such position would have further deteriorated. The Government claimed Rs. 12,098 Mn. from HDL on May 10, 2011, demanding repayment be made within a period of 2 years, on the capital advanced by the Government of Rs. 4,435 Mn., the balance of Rs. 7,663 Mn. being interest. Civil Law Ordinance Section 5 stipulates that the interest shall not exceed capital.

Furthermore, in terms of Section 364, read with Section 277 of the Companies Act No. 7 of 2007, no interest is payable by and/or chargeable from HDL, after the Petition for winding-up had been presented on November 17, 2006. In terms of Section 277 of the Companies Act No. 7 of 2007, the winding-up of a Company shall be deemed to have commenced at the time of presentation of the Petition for winding-up.

In the given facts and circumstances of HDL, Section 219 of the Companies Act No. 7 of 2007, which came into force on May 3, 2007 mandated the winding-up of HDL, and made the Directors personally liable for the debts of HDL, for having opposed the winding-up of HDL. In addition, Section 375 of the Companies Act No. 7 of 2007 prohibits the fraudulent trading by a Company, making Directors personally liable for its debts. Section 382 of the Companies Act No. 7 of 2007 empowers the Attorney General to criminally prosecute Directors of a Company in such circumstances.

Recently, by Order dated November 15, 2011 in HC (Civil) WP Case No. 16/2007/CO, re - the matter of Lanka Supermarkets Company Ltd., the Commercial High Court held that the Directors of the company are personally liable for the debts in excess of the assets of the company.

As per the definition of Directors specified in Section 529 of the Companies Act No. 7 of 2007, in respect of certain specific provisions therein, particularly Sections 187, 188, 189, 190, 197, 374, 375, including also Sections 191 to 195, persons in accordance with whose directions or instructions, Directors of a Company would act, are also deemed to be Directors of a Company.

In circumstances of serious loss of capital, where 50% of the Share Capital of a Company is eroded, in terms of Section 220 of the Companies Act No. 7 of 2007, the Directors are bounden in duty to call for an Extra-ordinary General Meeting, to *inter-alia* explain the extent of losses, causes therefor, and steps being taken to recoup the losses. In the case of HDL, the entire Share Capital had been eroded, but nevertheless its Directors had dismally failed to comply with the mandatory provisions of Section 220 of the Companies Act No. 7 of 2007, since May 2007.

Section 187 to 190 of the Companies Act No. 7 of 2007 stipulates the 'Duties of Directors' and Section 188 thereof prohibits a Director from acting or agreeing to act in contravention of any provisions of the said Act.

Hence, the Government Directors of HDL, appointed by the Minister of Finance, who exercised the management control of the HDL Board, with the Government being a 64% Shareholder of HDL, and who opposed the Winding-up of HDL and acted in blatant and flagrant violation of the Companies Act No. 7 of 2007 stood and stand personally liable for the debts in excess of the assets of HDL, which is to the Government i.e the public.

Such Directors who have transgressed the law and have caused the foregoing losses to the Government i.e. the public, ought be held accountable and responsible. How can one expect ordinary citizens to comply with the statutory law, when the Government, itself, brazenly violates the same ? Ought not the Government enforce the statutory law against all those concerned, without any apprehensions or favour, regardless of whoever they are, inasmuch as political opponents are expeditiously prosecuted ?

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## Thiru trims Hilton!

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- Hotel Developers successfully negotiates down total fees to be charged by global brand in running premier 5-star in Colombo to 11.75% of Gross Operating Profit from 33%
- New proposed management agreement before Cabinet Sub Committee for Revival of Underperforming State Enterprises to help save Rs. 171 m per annum for owning company
- 1984 agreement offering unilateral and perpetual extensions to operating term now reduced to 2019 from the original 2037, extendable further on mutual terms for successive periods of 10 years

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The Board of Directors of Hotel Developers (Lanka) Plc led by Chairman Thiru Nadesan has succeeded in negotiating a highly-favourable new deal for Colombo's premier five-star with its management partner Hilton Worldwide.



The deal, firmed up following several rounds of negotiations, envisages total fees to be charged by Hilton Worldwide and its Singapore regional office in managing the Colombo property to 11.75% of Gross Operating Profit (GOP) from the current 33% of GOP.

The latter has been widely considered by hotel experts as exorbitant whilst the global norm is around eight to 10% of GOP. Despite requests, previously Hilton had been allegedly adamant, refusing to revise downwards except up to 26%. In that context the new proposed fee of 11.75% is being described as a breakthrough.

Sources said that the new fee proposed would result in a considerable saving of Rs. 171 million per annum.

This is likely to make Hotel Developers more viable and improve prospects for refurbishment, though it continues to be saddled with a Rs. 10 billion loss in addition to debt worth Rs. 12 billion.

In the company's 2009/10 Annual Report, the management fees and other group charges paid to Hilton Worldwide between 2011 and 2010 was put at a hefty Rs. 1.37 billion.

Another significant negotiation was reducing the operating term of Hilton to 2019 as opposed to 2037 as per the original agreement signed. Previously Hilton had the right to extend the operating term unilaterally and perpetually, whereas under the new deal further extensions would be on mutual terms and for successive periods of 10 years.

In view of the absence of the restriction clause in the original deal signed in 1984, it has been proposed that Hilton will not be allowed to operate another hotel within a 25 kilometre radius of its existing property, excluding Hilton Residencies (formerly JAIC), which is also managed by Hilton at an estimated fee of 11% of GOP. The exclusivity clause however ensures that the marketability of Hilton Colombo is not compromised. Hilton has proposed the area of restrictions to be limited to 15 kilometres.

The new proposed agreement is before the Cabinet Sub Committee on the Revival of Underperforming Enterprises as Hotel Developers was acquired by the State under the Revival Act recently.

Among other new conditions is for all material procurement for the hotel to be in compliance with Government guidelines since Hotel Developers is now under the Revival Act. A fresh requirement is to bring the Power of Attorney given to Hilton in line with the provisions of the Companies Act of 2007.

Industry analysts noted that Hilton continues to be the most sought after 5-star property in the city and it has remained committed to Sri Lanka even amidst the worst of times. This, it was pointed out, needs to be recognised.

However, the hotel needs urgent refurbishment especially ahead of the Commonwealth Heads of Government's Meeting which Sri Lanka will host in 2013 and Hilton being the first choice for visiting international leaders.

With Shangri La planning to open shop by 2015 and several other major brands expressing interests to launch operations, Hilton also needs a total overhaul in addition to expansion to better cater to the envisaged boom in leisure and business travellers to the country.

At present Hilton Colombo commands around 384 rooms, whilst it has enough space for new development.

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