Hotel management contract disputes: Importance of “fiduciary” duties in Owner-Operator lawsuits

17 January 2012

Hotel Lawyer on Hotel Management Agreement disputes between Owners and Hotel Operators.

While there are always disputes simmering between hotel owners and hotel operators, the past few years has witnessed a big increase in the number of disputes ripening to litigation and arbitration. In a recent article, we discussed some of the root causes of this trend and role of the economy. That article was entitled, “Litigation and disputes between hotel owners and operators are on the rise. Why?”

I believe that most owner-operator disputes stem from the owner’s belief that the operator is not operating the hotel in a satisfactory manner and is treating the owner unfairly. A bad economy drives the parties to take action. When discussions fail to resolve the issues, litigation or arbitration claims often result.

Operators as fiduciaries: Why is this important and what does it mean?

As I mentioned in the recent article, some of these disputes pivot on the fiduciary responsibility of the operator. This is an important legal concept for hotel owners to understand. Generally, a hotel operator is the “agent” of the owner. Every agent is a fiduciary. A fiduciary has many duties such as a duty of loyalty, full disclosure, and noncompetition. A fiduciary also has a duty to prefer his principal’s interest (the owner’s interests) over his own interests.

I discussed these important concepts in a sidebar recently published in an article by Jason Freed of HotelNewsNow (a division of Smith Travel Research) in his article, Economic woes drive owner-operator disputes. I have reprinted that sidebar below with a few formatting edits to make the reading a bit easier.

So what if an operator is a “fiduciary”?

By Jim Butler
Chair, JMBM’s Global Hospitality Group®
Hotel Lawyer and author of HotelLawBlog.com

The difference between an ordinary contract and a contract with a fiduciary

“In a typical contract between two parties, say you and a contractor putting in a concrete driveway for your home, neither party is a fiduciary to the other. You are each free to act in your own best interest within the terms of the contract.

In contrast to the typical business contract, the hotel management agreement creates a completely different type of legal relationship between the hotel owner and the hotel operator. It has repeatedly been held by the courts to create an “agency” relationship. Operators originally crafted this relationship because they wanted total control of the hotel without ever having to get approval of the owner. They got this control by being designated the owner’s agent to hire all employees, set up all bank accounts, enter into all agreements for the hotel, set marketing strategies, and so on.
Fundamental rules apply to every agency and fiduciary relationship

But over hundreds of years, the English common law developed fundamental legal principles that will apply in every agency situation. For example, an agent is a fiduciary. A fiduciary has many duties such as a duty of loyalty, full disclosure, and noncompetition. Some of the rights and duties that come with an agency relationship can be waived by a fully informed written consent, and others cannot be waived no matter what.

Every hotel manager is the agent and fiduciary of the owner

We believe that virtually every hotel manager is the agent of the owner, no matter what the hotel management agreement says. Some operators like Marriott try to avoid the “agency” label in their management agreements. Other major brands usually acknowledge they are agents and deal with their obligations in a different manner. But it is very common for any knowledgeable party to look for and to assert that the hotel operator is an agent.

Morals of the marketplace versus fiduciary duties

If the operator is an agent, then as a matter of law, the operator assumes fiduciary duties (except under the law of Maryland, which Marriott had amended to remove the universal common law provision). These fiduciary duties go beyond the terms of the hotel management agreement and are more strict than the so-called “morals of the marketplace” that governs typical commercial contracts. Again, it is common for knowledgeable hotel counsel to assert and seek to enforce these fiduciary duties.

One of those fiduciary duties is the obligation of the agent to prefer the principal’s interests (i.e. the interest of the hotel owner) over its own. This is certainly not a novel claim in agency law, but has not been that common in hotel management agreement litigation to date.

Hotel Management Agreement Audit™

Establishing the existence of the agency relationship and the corresponding fiduciary duties is best done by a careful examination of the terms of the hotel management agreement and all the other facts to assess these rights and duties.

At JMBM, we do this with something we call the Hotel Management Agreement Audit™. This is not a financial audit performed by accountants and auditors, it is a legal and business analysis performed by experienced lawyers and hotel advisors.

More resources on Hotel Management Agreements

You will find a lot more valuable information related to this topic on the Hotel Law Blog under the topic “Hotel Management and Franchise agreements”, including a classic article on the 5 biggest mistakes a hotel owner can make.

Also see The HMA Handbook: Hotel Management Agreements for Owners, Developers, Investors and Lenders.

Articles about terminating hotel management agreements
Marriott Loses Appeal in Eden Roc Case: Why all long-term hotel management agreements are now terminable

How to terminate a hotel management agreement: A Tale of Two Hotels — Marriott’s Edition Waikiki and Fairmont’s Turnberry Isle Resort

Terminating hotel operators: M Edition lawsuit against Marriott has a new twist — Marriott is replaced overnight

More on M Waikiki Edition lawsuit against Marriott – What Marriott’s General Counsel says

M Waikiki’s Edition lawsuit against Marriott and Ian Schrager – an owner’s HMA dispute with Marriott

Terminating hotel operators: Turnberry Resort drops Fairmont flag

Hotel management agreement terminations — Is there a better way?

Terminating hotel management agreements when things don’t work? Not easy, but not impossible either.

Hotel bankruptcy trump card. Terminating hotel management agreements without liability — the alchemy of lead to gold for troubled hotels and hotel loans?

Ritz-Carlton Bali hotel management agreement termination further court order

Ritz-Carlton breached contractual and fiduciary duties under hotel management agreement giving rise to free termination, $10.3 million in damages plus attorneys fees. When will hotel operators “get it”?

How to terminate a hotel management agreement when an operator really deserves it!

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer, signing off. We’ve done more than $87 billion of hotel transactions and have developed innovative solutions to unlock value from hotels. Who’s your hotel lawyer?

Our Perspective. We represent hotel lenders, owners and investors. We have helped our clients find business and legal solutions for more than $87 billion of hotel transactions, involving more than 3,900 properties all over the world. For more information, please contact Jim Butler at jbutler@jmbm.com or +1 (310) 201-3526.

Jim Butler is a founding partner of JMBM, and Chairman of its Global Hospitality Group® and Chinese Investment Group™. Jim is one of the top hospitality attorneys in the world. GOOGLE “hotel lawyer” and you will see why.

Jim and his team are more than “just” great hotel lawyers. They are also hospitality consultants and business advisors.
They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them.