Hotel owner-operator disputes: Marriott v Eden Roc — what it all means for terminating hotel management agreements

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Hotel owners: How the appellate decision in Marriott International v Eden Roc can affect your hotel investment (and why you should understand the law behind the court’s decision)

As we reported in our 27 March 2013 blog, a New York Appellate Division court made it possible for the owners of the Eden Roc Renaissance hotel in Miami Beach to oust Marriott as its operator — despite the long-term hotel management contract between the two, which would have lasted another 43 years. (See "Marriott loses appeal in Eden Roc case: Why all long-term hotel management agreements are now terminable.")

Setting the stage: owner-operator disputes over hotel management agreements

The relationship between a hotel owner and hotel operator is complex. While the owner bears the financial risk of the hotel’s success or failure and its gain or loss in value, the operator has the exclusive right to manage the owner’s business and is paid "off the top" whether the hotel is profitable or not. The contract between the owner and operator — the hotel management agreement — typically transfers control of the hotel’s assets to the operator.

Hotel owners nationwide are keenly aware of both the benefits and impediments of long term hotel management agreements with branded operators (and nearly all such contracts are long term, often running 40 or 50 years). On the upside, the brand can provide stability, consistent standards, a reservation system, marketing expertise and professional staffing. But the downside can be hard for owners to live with — brands can rigidly incur needless expenses, be unresponsive to market conditions and impervious to the owner’s need to run a profitable business and protect its asset.

While the majority of hotel owners and operators work hard to achieve a balance that is a win-win for both parties, it is easy to understand how things can go badly, fast.

Background: The Eden Roc – Marriott dispute

On March 30, 2012, Key International, the owner of the 631-room Eden Roc hotel in Miami Beach, terminated Marriott as the hotel's operator “...following years of mismanagement of the property and a failure to maximize the Eden Roc brand,” according to its news release. But Marriott refused to acknowledge the termination or vacate the hotel. In October 2012, Eden Roc attempted to remove Marriott from the hotel’s premises, but Marriott refused and obtained a temporary restraining order barring the hotel’s owner from trying to oust it as Eden Roc’s operator.

The owner appealed the decision and on March 25, 2013, a New York appeals court issued an order that vacated the lower court’s injunction. Key International is now free to terminate Marriott as Eden Roc’s operator.
What the *Eden Roc* decision means to hotel owners

Now that an appellate court has ruled that a hotel owner can terminate a hotel management agreement with its operator — the second time an appellate court has done so — owners are asking, “Does this mean I can terminate my hotel operator, even if I have a long term contract with them?”

The short answer is “Yes.” Hotel owners can regain control of their hotel property when they see fit. This is good news for hotel owners.

But there are a number of very important caveats that will help frustrated hotel owners determine whether this is the best course of action when they are unhappy with their operators.

The “power” vs. the “right” to terminate a contract

The *Marriott International v Eden Roc* decision establishes that an aggrieved hotel owner can get rid of an operator despite the terms of a long-term, no-cut hotel management agreement that may run for 50 years or more.

But this is not necessarily a “free” termination (although it could be depending upon all the facts and circumstances). Hotel owners need to understand that there may be serious consequences to pay if they terminate a hotel management contract, in terms of liability and cost.

*Eden Roc* reaffirms the “power” (i.e. ability) of an owner to terminate a hotel management agreement and to regain control of its property for any reason.

However, if the owner did not have the “right” to terminate the agreement — adequate legal justification such as a material breach by the operator — then the owner will be liable to the operator for damages resulting from terminating the contract. Those damages may be very substantial, and no owner should undertake a termination of a hotel management agreement without expert advice on alternative approaches, as well as the potential consequences of the action.

The Hotel Management Contract as a “Personal Services Contract”

In *Marriott International v Eden Roc*, a unanimous panel of the Appellate Division, First Department of New York agreed that the hotel management contract “is a classic example of a personal services contract that may not be enforced by injunction.”

At first blush to someone outside the hotel industry, this case might seem unremarkable. It restates and affirms legal principles that have been used throughout the United States for more than a century as to the rules applicable for a mandatory injunction to enforce a personal services contract.

However, the fact that the *Eden Roc* decision is based *solely* on the inability to use an injunction to enforce a personal services contract is novel in the hotel industry. To date, all other lawsuits where terminating the hotel management agreement is at issue have also involved the use of “agency” principles.
In *Marriott International v Eden Roc*, the court did not rely on agency principles at all. In fact, the court stated that it found no agency relationship, but the court still found the owner could terminate the agreement and Marriott could not enforce it by injunction.

By the way, as noted below, we disagree with the court’s determination that there was no agency relationship under the management agreement, but that is a different issue for another discussion and another case.

**What’s all the fuss about “agency”?**

After a few high profile lawsuits over the termination of hotel management contracts (see the *Woolley*, *Pacific Landmark* and *Skopbank* cases with citations at the end of this article), most operators accepted that under the typical hotel management agreement the operator would be the "agent" of the owner, with all the attendant implications of fiduciary duty. Many sought expanded waivers of certain fiduciary duties, such as the duty not to compete, and the duty not to take undisclosed kickbacks on purchases, but most operators did not fight the basic concept that they were agents, and as such they were subject to the "cardinal rule of agency" restated in *Woolley* that a principal (the owner) always has the power to terminate his agent (the operator).

However, Marriott and a few other operators took a different track. And with zealous focus, they sought to strip their management contracts of any "agency" overtones or language, while retaining complete control over hotel operations. These contracts apparently confused some of the lower courts into thinking that because they purported to be non-agency contracts, they must be so, and therefore could not be terminated under agency principles.

The *Eden Roc* court noted in a one-sentence conclusion that the hotel management agreement did not create an agency relationship. We do not believe that this was a correct conclusion, or that it will withstand the test of time when the question is brought before an appropriate appellate decision, despite all the attempts of Marriott and certain other operators to avoid an agency characterization.

But in denying the agency relationship, the *Eden Roc* court gave owners a tool that is potentially even more powerful than the agency relationship when it comes to the power to get control of a hotel back from an operator. And it certainly destroyed the value of Marriott’s elaborate attempts over many years to avoid this result by seeking to avoid an agency relationship.

**What about breach of contract and damages?**

It is important to understand that the *Eden Roc* decision did not deal with the issue of damages for a possible breach of contract. This lawsuit was about a battle for control of the hotel, and a determination of whether Marriott had the right to continue operating the hotel against the hotel owner’s wishes. The court ruled that Marriott did not.

The issue of damages between Eden Roc and Marriott will be left until a later date.

**New York, Florida and California agree on this result. What about other jurisdictions?**
The appellate court’s ruling firmly establishes that hotel operators have the power to terminate management services agreements with their operators and regain control of their properties.

Although the *Eden Roc* court is interpreting and applying New York law, the same rule is pervasive throughout the United States. When our hotel lawyers handled the *Fairmont v Turnberry* case in Miami which also involved terminating a hotel management agreement, our research indicated the same legal result under both New York law (the law governing the Turnberry contract) and Florida law (which a Florida court might refer to in a conflict of laws analysis).

An appellate court in California court concluded the same thing in a lawsuit involving Doug Manchester’s hotels in San Diego in the *Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc.* litigation, another instance in which an appellate court voided Marriott’s attempt to continue to control a hotel where the owner acted to terminate it.

In other words, although the outcome of the legal question decided by *Marriott International v Eden Roc* could theoretically vary if governed by different state law, at least in California, New York and Florida, the law is pretty much the same. We think this will hold true throughout most of the United States but hotel owners with contracts governed by the laws of other jurisdictions would be wise to analyze this carefully before terminating a hotel management contract.

In fact, an owner should not take any action in an owner-operator dispute involving a hotel management agreement without advice from experienced counsel at every critical stage of the process, starting at the earliest possible time.

**How will the *Eden Roc* decision change disputes between owners and operators?**

This case provides an important reaffirmation of principles that will be critical for a few owner-operator disputes. If you are in one of those disputes, it may change the entire course of your situation, and for those parties, it will be a watershed event. We are frequently involved in these kinds of events and we never underestimate the impact it may have for those affected.

However, we do not see any wave of terminations being inspired by this decision. Most owner-operator relations are amicable and satisfactory. And even when they are not, the best solution is always a mutually workable result. Most difficulties are resolved at the negotiating table in a good faith exchange of viewpoints and business alternatives.

But when disputes cannot be resolved by discussion, *Marriott International v Eden Roc* will be an important case in the litigation dynamics between owners and operators.

**Will *Marriott International v Eden Roc* change how hotel contracts are written?**

This case is the second time Marriott has gotten a bloody nose in trying to avoid the result that equity demands — namely that no operator can force its agency or its personal services on another if that party wishes to terminate.

Lawyers for the brand operators will continue to write contracts that are favorable to the brand and lawyers for hotel owners will negotiate hard to level the playing field and achieve a contract that is fair to the owner. That’s what lawyers do. But no amount of contractual acrobatics or gobbledygook will avoid the inevitable result — that owners have the power to
terminate the personal services of the operator.

The sooner operators accept this, the sooner operators and owners can get back to the real business of working together to provide great lodging for guests, consistent brand standards that make sense, and efficient operation of hotels that satisfies the legitimate needs of operators and provides a fair return to owners and their capital partners.

Important legal decisions on hotel owner-operator relationship

For our friends who want the legal citations for some of the important legal decisions referred to in this article, here are the details, as well as the common names we use to refer to these cases:

- **Woolley v Embassy Suites Inc. (“Woolley”),** 278 Cal. Rptr. 719 (Ct. App. 1991)
- **Pacific Landmark Hotel Ltd. v Marriott Hotels Inc. (“Pacific Landmark”),** 23 Cal. Rptr. 2d 555 (4th Dist. 1993)
- **Government Guar. Fund of the Republic of Finland v Hyatt Corp. (“Skopbank”),** 95 F.3d 291 (3d Cir. 1996)
- **FHR TB, LLC v. TB Isle Resort, LP (“Tumberry” or “Fairmont v Tumberry”),** 865 F. Supp. 2d 1172 (S.D. Fla. 2011)

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We have developed some very effective tools for dealing with long-term hotel management agreement problems. Clients really value our more than 20 years of business and legal experience to help them evaluate the situation, identify alternatives, develop successful strategies and execute them.

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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.