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THE PENDULUM SWINGS . . .

SURVEY OF MANAGEMENT AGREEMENT LITIGATION

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Notably, Mr. Bosch was trial counsel in the landmark Woodley Road case that resulted in a multi-million dollar jury verdict against a major hotel management company on behalf of the hotel owner. Recent engagements include matters adverse to Marriott (including Ritz-Carlton), Hyatt, Starwood (including Le Meridien), IHG, and operators.

However, this willingness to go to trial has allowed Mr. Bosch to pursue other methods of alternative dispute resolution for his clients, including mediation and arbitration in a number of domestic and international alternative dispute resolution forums. As a result, many of his matters settle, and avoid the costly expense of a trial for his clients.

Mr. Bosch also regularly counsels clients on the negotiation and enforcement of management contracts and franchise agreements, asset management, loan workouts, and intellectual property issues.

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I. SCOPE OF ARTICLE

The pendulum continues to swing, most recently in favor of owners in their on-going campaign for transparency, fairness, and contractual compliance by hotel operators.

A perpetual point of contention between hotel owners and operators is how to define their relationship under a hotel operating agreement. Operators have been wrestling with the implications of having their management contracts give rise to an "agency" relationship. Characterization of the owner-operator relationship is important not only in determining the parties' respective rights and obligations throughout the relationship, but also in resolving disputes between owner and operator and, if necessary, terminating an operator.

As branded hotel companies sold off real estate and developed their management fee revenue models in the 1990s, just as the economy put pressure on the shrinking bottom line being absorbed by hotel owners, trust eroded and lawsuits followed. The seminal decisions of that decade, ending with the *Woodley Road* case, set a new high water mark for owners, as operators were at risk for misconduct that was becoming commonplace.

The next decade, however, saw the pendulum swing back to the operators. While owners were suffering financially in the wake of 9/11, and then the economic disaster at the end of the decade, operators were cleverly rewriting contracts and pressuring friendly legislatures to effectively authorize misconduct, without full or fair disclosure to owners.

However, owners in the second decade of the 21st century are turning once again to the courts, not arbitrators, to try to reclaim control over their hotels, reminding the branded operators that the interests of the owner, and not of the brand, are the cornerstone of their business.

II. THE BATTLEGROUND: THE NATURE OF THE OWNER/OPERATOR RELATIONSHIP

An agent/principal relationship is significant to hotel operations in several respects. An agent is a fiduciary of the principal.[1] As a fiduciary, the agent owes to the principal a variety of fiduciary duties, any breach of which subjects the agent to liability independent of its liability under the express written terms of the contract between the parties.

First and foremost among the agent's fiduciary duties is the duty of loyalty, which requires the agent to act at all times in the principal's best interest when acting in connection with the agency.[2] The agent's own interest is subordinate to the interests of the principal.[3] For example, the agent is not free to use its position to "acquire a material benefit," particularly when doing so would be adverse to the principal's interest.[4] Other duties owed by the agent to the principal include the duties of due care, diligence and competence in actions taken pursuant to the agency relationship. In the hotel management context, if the operating agreement vests broad

[1] RESTATEMENT (THIRD) OF AGENCY §§ 1.01, 8.01 cmt. b (2006).
[2] *Id.* § 8.01.
[3] *Id.* § 8.01 cmt. b.
[4] *Id.* § 8.02 & cmt. b.

discretion in the operator, the operator must competently exercise such discretion in good faith and with due care.

The agency relationship also is relevant in the owner/operator context because agency relationships are terminable at the will of the principal (here, the owner). Importantly, an agent does not need to have breached a duty owed to the principal in order for the principal to end the agency relationship. The relationship ceases to exist as soon as the principal notifies the agent that the agent no longer has authority to act on the principal's behalf. A hotel owner, therefore, should be free to terminate the operating agreement with the operator at any point, regardless of whether the operator violated its duties to the owner. If the termination is wrongful (that is, there is no justification for the termination) the terminating owner may be subject to damages for wrongful termination. But the flag still must come down.

III. THE 1990s: OWNERS FIGHT FOR THEIR RIGHTS

A seminal case discussing the owner/operator relationship is *Woolley v. Embassy Suites, Inc.*[5] Embassy Suites operated hotels for the plaintiff owners, who sought to terminate their management agreements with Embassy Suites for nine hotels.[6] Embassy Suites obtained a court order enjoining the terminations, but the appellate court reversed the order.[7] The California First District Court of Appeal explained that "a principal who employs an agent always retains the power to revoke the agency"[8] and held that Embassy Suites was an agent of the owners. According to the court, "it should always be within the power of the principal to manage his own business and that includes the power of the principal to reassume the control over his own business which he has but delegated to his agent."[9] Consistent with the *Woolley* decision other courts, including the United States District Court for the District of Delaware in *Woodley Rd. Joint Venture v. ITT Sheraton Corp,* have found that the hotel management agreements create agency relationships that are terminable at will. *See Woodley Rd.*, 1998 WL 1469541, at *6 (D. Del. Feb. 4, 1998).[10]

[5] 227 Cal. App. 3d 1520 (Cal. App. 1991).
[6] *Id.* at 1525.
[7] *Id.*
[8] *Id.* at 1529.
[9] *Woolley*, 227 Cal. App. 3d at 1530–31 (citation and quotations omitted). A narrow exception to the rule that agency relationships are terminable at will exists when the agency is "coupled with an interest." *See, e.g., id.* at 1529 ("Save in the case of an agency coupled with an interest, a principal has the *power* to revoke an agent's authority at any time before the agent has completed performance." (citations and quotations omitted)). When an agency relationship is created for the benefit of the agent and the agent receives, in addition to authority, "a specific, present and coexisting beneficial interest in the subject matter of the agency," the agency relationship becomes irrevocable. *Id.* at 1532 (citations and quotations omitted).
[10] *See also Pac. Landmark Hotel, Ltd. v. Marriott Hotels, Inc.*, 23 Cal. Rptr.2d. 555 (Cal. Ct. App. 1994.) ; *Gov't Guar. Fund v. Hyatt Corp*., 95 F.3d 291, 297 (3d Cir. 1996) (recognizing the trial court's holding that a hotel management agreement "created a revocable agency that ended once [the owner] gave notice of its termination" (citation and quotations omitted)

IV. THE 2000s: OPERATORS FIGHT BACK THROUGH CLEVERLY WORDED OPERATING AGREEMENTS AND LEGISLATION

In the 2000s, many operators engaged in an effort, individually and in some instances collectively, to whittle away at the hard-won progress made by owners in asserting their rights through the courts. They did this through clever drafting of operating agreement terms and – in Maryland – through statutory relief.

For example, many hotel operators insisted on including language in their form operating agreements declaring that the operator is an "independent contractor." There is legal authority that an independent contractor also can be an agent, but the import of this language is clear – operators are setting up an argument that they are not agents, without expressly saying as much. Some operators have been particularly clever, arguing that language disclaiming any relationship "like a partnership or joint venture" also disclaims an agency relationship and fiduciary duties, without expressly disclaiming agency or even mentioning fiduciary duties. While the language here was intended to address the parties' rights and obligations vis-à-vis third parties, operators instead have taken boilerplate language that most owners gloss over and used it to disclaim any duties of loyalty, care or good faith in performing their obligations. In some instances, operators have buried express disclaimers of agency in this boilerplate. Some owners, for their part, have unwittingly allowed operators to use this clever drafting to create arguments that the parties "mutually intended" to allow the operator to walk away from the implied duties of loyalty, due care, diligence and competence.

In addition to adding new language they claim is "non-negotiable," several operators coordinated efforts to seek legislative "relief" from these implied duties. At the request of a number of hotel operating companies, the Maryland state legislature enacted Title 23 of the Commercial Law section of the Maryland Code, which is applicable specifically to parties to hotel operating agreements. The statute subordinates common-law agency principles to the express terms of an operating agreement. Among other implications, the statute suggests that the owner and operator can agree that no agency relationship exists despite factors that would otherwise indicate an agency relationship. The statute also allows operators to argue that there are no implied fiduciary duties, even where the terms of the operating agreement otherwise would suggest that the operator has been entrusted to operate the hotel and to manage the owner's accounts for the benefit of the owner.

V. THE 21ST CENTURY: OWNERS REGAIN SOME GROUND

Three recent court decisions portend a changing landscape in the relationship between hotel owners and operators. In all of these cases, the courts deemed the operating agreements to be contracts for personal services that are terminable at the will of the owner.

A. *Marriott International, Inc. v. Eden Roc, LLLP/Eden Roc, LLLP v. Marriott International, Inc., et al.*

Eden Roc, LLLP, the owner of the Eden Roc Renaissance Hotel in Miami Beach, Florida, brought a lawsuit in the New York Supreme Court against Renaissance Hotel Management Company and its parent company, Marriott International, for breach of the management

agreement that installed Renaissance as the operator of the hotel.[11] Eden Roc sought to terminate the management agreement and remove Renaissance from the hotel. After a failed attempt to remove Renaissance from the hotel, Eden sought an injunction from the court requiring Renaissance to leave the hotel, arguing that the management agreement was one for personal services. A personal services contract is one that requires the rendition of services which require the exercise of special skill and judgment. In most jurisdictions, a court cannot compel specific performance of a personal services contract. Eden Roc also argued in a footnote that Renaissance was Eden Roc's agent, but that the court need not reach the agency question for purposes of the motion before it.[12]

The New York Supreme Court rejected Eden Roc's argument that the management agreement was a contract for personal services.[13] The court also rejected Eden Roc's argument that an agency relationship arose by virtue of the management agreement, noting that "the parties specified the nature of their relationship in the Agreement, stating '[i]n the performance of this Agreement, [plaintiffs] shall act solely as an independent contractor.'"[14]

Eden Roc appealed on both the personal services and agency issues. The Appellate Division agreed on the personal services grounds, reasoning that the "detailed management agreement places full discretion with [Renaissance] to manage virtually every aspect of the hotel. Such an agreement, in which a party has discretion to execute tasks that cannot be objectively measured, is a classic example of a personal services contract that may not be enforced by injunction."[15] At the same time, the Appellate Division held that, "[w]hile it is unnecessary to reach the question, we note that, contrary to defendant's contention, the agreement is not an agency agreement. Defendant lacks control over plaintiff, the alleged agent, since the agreement provides for plaintiff to have unfettered discretion in managing the hotel's operations."[16] The court did not elaborate on the agency aspect of its decision.

In light of the Appellate Division's order, the lower court ruled that Eden Roc had the authority to terminate and eject Renaissance from the hotel as and when it wished, subject to Renaissance's and Marriott's damages claims for wrongful termination.[17] According to the court, "if Eden Roc tells Marriott/Renaissance to get out, Marriott/Renaissance must follow that directive."[18]

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[11] First Amended Verified Complaint, *Eden Roc, LLLP v. Marriott Int'l, Inc.*, Index No. 651027/2012 (N.Y. Sup. June 29, 2012).
[12] *Id.* at 11 n.2.
[13] *Id.* at 4.
[14] *Id.* at 6.
[15] Order, at 1-2, *Marriott Int'l, Inc. v. Eden Roc, LLLP*, Index No. 653590/2012 (N.Y. App. Div. March 26, 2013).
[16] *Id.* at 2.
[17] Hearing Transcript on Order to Show Cause, at 8, *Marriott Int'l, Inc. v. Eden Roc, LLLP*, Index No. 653590/2012 (N.Y. Sup. May 21, 2013); *see also* Declaratory Judgment and Order, *Marriott Int'l, Inc. v. Eden Roc, LLLP*, Index No. 653590/2012 (N.Y. Sup. May 21, 2013).
[18] *Id.* at 6-7.

B. *RC/PB, Inc. v. The Ritz-Carlton Hotel Company, L.L.C. et al.*

Meanwhile, a Florida court tackling a dispute between a hotel owner and operator reached a parallel, if somewhat divergent, conclusion. RC/PB, Inc., the owner of what was formerly the Ritz-Carlton, Palm Beach, brought claims against the operator Ritz-Carlton and its parent company, Marriott. RC/PB sought and received a declaration from the court that RC/PB had the power to terminate Ritz-Carlton as the operator, based on a personal services theory.[19] The court's "examination of the Operating Agreement as a whole show[ed] a delegation to Ritz-Carlton of a broad range of discretionary authority" in operating the hotel, which "'undisputedly call[ed] for the rendition of services which require[d] the exercise of special skill and judgment.'"[20] The owner exercised the power recognized by the Court, and terminated Ritz-Carlton on July 1, 2013. The parties' respective damage claims are set to go to trial in late 2014.

C. The *Turnberry Isle* Case

In the case of *FHR TB, LLC v. TB Isle Resort, L.P* ("*Turnberry Isle"*), the owner of the hotel formerly known as the Fairmont Turnberry Isle Resort and Club in Aventura, Florida evicted the operator, Fairmont, from the hotel without any prior notice on the ground that the relationships was an agency that was terminable at the will of the principal.[21] The owner did not assert that the termination was "for cause" because of a breach by the operator. Fairmont sought an injunction from the United States District Court for the Southern District of Florida to reinstate it as operator.[22]

The court denied Fairmont's injunction, finding that the hotel management agreement created an agency relationship. The existence of an agency relationship was not in dispute, but the operator did advance half-baked arguments against the self-help eviction by the owner. The court stated "[t]he Restatement of Agency recognizes that hotel managers are agents of the owners of the properties they operate."[23] The court further held that "hotel management agreements are personal services contracts" because they call for "'the rendition of services which require the exercise of special skill and judgment . . . managerial services [that were] wide-ranging and involve daily discretionary activities . . . [including] hiring and firing managerial personnel and hundreds of other employees, contracting for . . . services and the like."[24] On that basis, the owner's self-help eviction and termination of Fairmont was upheld, subject to a liquidated damages provision for early termination without cause.

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[19] Order on Plaintiff's Motion for Partial Summary Judgment Regarding the Power to Terminate, at 7-8, *RC/PB, Inc. v. The Ritz-Carlton Hotel Company, L.L.C.*, Case No.: 502011CA010071XXXXMB (Fla. Cir. Ct. April 19, 2013).

[20] *Id.* (quoting *Woolley v. Embassy Suites, Inc.*, 227 Cal. App. 3d 1520, 1534 (Cal. Ct. App. 1991)). The Florida trial court did not reach the agency issue, but in a separate ruling granted summary judgment for Ritz-Carlton on RC/PB's breach of fiduciary duty claims, finding that the parties were dealing at arm's length. While that interlocutory ruling remains subject to appeal, it does evidence some judicial hostility against owner claims that go beyond breach of the management contract.

[21] *Turnberry Isle*, No. 11-23115-CIV-Graham/Goodman, 2011 U.S. Dist. LEXIS 155742, at *5 (Sept. 26, 2011.)

[22] *Id.* at *8.

[23] *Id.* at *78 (internal citations omitted).

[24] *Id.*at 86 (internal citations omitted).

VI. CONCLUSION

Whether through the existence of an agency relationship or because a hotel management agreement is deemed a personal services contract, the courts are clear – owners have the power to terminate the hotel management relationship at will. Clever drafting of management agreement boilerplate concerning the "relationship of the parties" has given operators the opportunity to assert arguments that, in some courts, have been successful in whittling away at the long-recognized agency decisions from the 1990s. Owners have fought back, relying more heavily on the personal services nature of these agreements. But operators already are using the power of the pen, injecting "personal services" disclaimers into new form management agreements.

The battleground remains uneven, as operators also have succeeded in limiting their exposure to fiduciary duties. In some sense, owners should be especially wary of dealing with operators unwilling to acknowledge, for example, a duty of loyalty and disclosure to owners in connection with how the operator manages the owner's hotel, including the owner's accounts at the hotel. In the hotel context, where the operating agreement necessarily vests broad discretion in the operator, fiduciary duties require that the operator competently exercise such discretion in good faith and with due care for the benefit of the owner. Operators who fight these duties in courts cannot credibly suggest that they are truly honoring their obligations to operate the hotel for the benefit of the owner, or that they are genuinely interested in transparency.

As such, owners must be vigilant when negotiating management agreements to avoid operators' traps and must continue to challenge operators' attempts to evade their fiduciary duties. If the operator's approach at the bargaining table is "take it or leave it" with respect to its form management agreements, then owner may wish to reconsider its selection of the operator.