The Midnight Raid—Can a Hotel Manager Prevent Termination of its Management Agreement?

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Hotel managers invest substantial capital into their hotels, including dedicated branding, sales and financial personnel, and at times upfront injections known as "key money." Managers expect to recoup their investment based on the management fees and other incentives payable throughout the contract term, subject to any termination rights granted to the owner in the agreement itself. But what happens when, prior to expiration of the term and for reasons not expressly provided for in the management agreement, the owner evicts the manager from the hotel? What ability, if any, does the manager have under existing New York law to stave off eviction, or alternatively, seek judicial reinstatement? The authors of this article discuss these questions.

It is no secret that many major hotels operate on a third-party management model whereby the hotel's owner executes a long-term agreement granting extensive management rights and duties to an unaffiliated manager with a renowned brand name. These agreements limit the owner's right to terminate the manager to specified "for cause" events, or the manager's failure to meet sales performance criteria after a specified period of time.

In return for paying fees and surrendering control over important operational aspects of the hotel (*e.g.,* staffing, furniture, fixtures, and equipment, and food and beverage), the owner benefits from the manager's time-tested expertise and the right to trade on the manager's goodwill, *i.e.* to fly the manager's "flag." Often times, managers invest substantial capital into their hotels, including dedicated branding, sales and financial personnel, and at times upfront injections known as "key money." Managers expect to recoup their investment based on the management fees and other incentives payable throughout the contract term, subject to any termination rights granted to the owner in the agreement itself.

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New York precedent reveals two competing lines of cases in this regard.

The first line would deny reinstatement on grounds that management agreements are personal services contracts that an owner may terminate at any time, for any or no reason, subject only to the owner's liability for damages if a court found that the owner's actions breach the contract.

The second would grant reinstatement despite the owner's common law termination right because sophisticated parties to an arm's-length transaction, such as most owners and managers, may limit the scenarios under which an owner may terminate a manager, including by prohibiting self-help, and a court is bound to honor such limitations.

Management Agreements as Personal Services Contracts

Any analysis of an owner's common-law right to terminate a management agreement must begin with *Marriott Intern., Inc. v. Eden Roc, LLLP.*[1] Prior to *Eden Roc II*, the owner of the Miami Eden Roc Hotel used self-help to forcibly evict its manager (Marriott), in response to which the trial court[2] granted a temporary restraining order reinstating Marriott to the hotel.

The Appellate Division of the Supreme Court of New York, First Judicial Department, reversed the trial court, finding that "[s]uch 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."[3] In support of its holding, the First Department relied in part on § 367 of the Restatement (Second) of Contracts, which provides that "[a] promise to render personal service will not be specifically enforced" in part because of "the undesirability of compelling the continuance of personal association after disputes have arisen and confidence and loyalty are gone and, in some instances, of imposing what might seem like involuntary servitude."[4]

Some might conclude, based on the court's classification of management agreements as personal services contracts, that an owner's common law termination right is well-settled; however, apart from the Restatement, the authorities on which the First Department relied arguably compel the opposite result, *i.e.* a court may reinstate a manager if an owner's actions breached the parties' contract.

First, the First Department relied on its decision in *Wein & Malkin LLP v. Helmsley-Spear, Inc.*,[5] in which a property manager sought to confirm an arbitration award vacating termination due to an owner's failure to follow proxy procedures set forth in owner's partnership agreement.[6] The First Department reversed the lower court's confirmation of the award, holding that the arbitrator abused its discretion by vacating termination due to flawed proxy procedures.[7] On appeal, the Court of Appeals reversed, holding that the arbitrator did not abuse his discretion by requiring owner to follow applicable proxy procedures as a condi-

tion to terminating owner.[8] Accordingly, *Eden Roc II*'s reliance on its own prior decision appears to conflict with the Court of Appeals subsequent ruling that the arbitrator could enforce limitations on an owner's right to terminate the management contract.

Second, *Eden Roc II* relied heavily on *Woolley v. Embassy Suites, Inc.*,[9] a California case which relied on specific California statutory law providing that personal services contracts cannot be specifically enforced through injunctive relief. *Woolley* cites Cal. Civ. Code §§ 3390(1) and 3390(2) to conclude that "it is a fundamental rule that specific performance cannot be decreed to enforce a contract for personal services, regardless of which party seeks enforcement."[10] This statute is not binding on New York courts, and therefore a manager could argue that *Woolley* reflects California-specific policy, as embodied by California statutory law, and therefore does not apply outside California.

To the extent a New York court saw fit to seek guidance from other states, *Woolley* is not the only relevant precedent, and certainly not the most recent.

Maryland has statutory law directly on point, and legislative history underlying the statute explicitly takes aim at *Woolley.* Md. Code Ann., Com. Law § 23-102(a) provides that "[i]f a conflict exists between the express terms and conditions of an operating agreement and the terms and conditions implied by the law governing the relationship between a principal and agent, the express terms and conditions of the operating agreement shall govern." § 23-102(b) provides that "[a] court may order the remedy of specific performance for anticipatory or actual breach or attempted or actual termination of an operating agreement notwithstanding the existence of an agency relationship between the parties to the operating agreement."

According to legislative history, Maryland passed this law because "[b]eginning in 1991 (*i.e.* the *Woolley* decision), some out-of-state court rulings began applying the common law agency principles, rather than common law contract principles, to the legal relationships between hotel owners and operators."[11]

Therefore, to the extent the *Eden Roc II* court's cite to *Woolley* hints at New York's interest in other states' policies regarding specific enforcement of management contracts, a court would be equally entitled to consider this newer Maryland statute.

Freedom to Contract Permits Limitations on Termination

Two Supreme Court decisions hold that parties to an arm's-length management agreement may limit scenarios in which an owner may terminate a manager, including contracting away an owner's otherwise-extant common law right to terminate personal services contracts. Though these unreported decisions predate *Eden Roc II*, these cases provide support a court can rely on to reinstate a manager if self-help eviction violates a management agreement.

In *M Waikiki LLC v. Marriott Hotel Services, Inc. et al*,[12] after owner (Waikiki) evicted manager (Marriott) under cover of night with the use of security guards, Marriott sought — and the court granted — a temporary restraining order reinstating Marriott. In ruling from the bench after oral argument on the restraining order application, the court found:

> [T]he parties had entered into a very specific mechanism on how to terminate this agreement. And the most important part of this specific outline about how to terminate this agreement was the statement made in the contract that the two parties freely entered into, that the only way that you could terminate this agreement was to come to Court and get judiciously determined [relief] by a Court in New York State as to whether or not the agreement should be terminated . . . But, instead of allowing a judge to judiciously determine whether or not the agreement should be terminated or not, Waikiki then went forward and took it upon themselves to achieve the final remedy by, by self-helping themselves and throwing Marriott out. That was a direct contradiction of the mechanism that was set up between the parties as to the ways of going about to terminate this agreement.[13]

Concluding that Waikiki's use of self-help breached the management agreement, which governed irrespective of Waikiki's purported common-law termination right, the court ordered "Marriott be restored to the hotel as its manager with full duties . . . of everything that is stated in the agreement."[14]

Similarly, in *Madison 92nd Street Assoc., LLC v. Courtyard Mgmt. Corp.*,[15] the owner alleged that its manager breached its common-law fiduciary duties by mismanaging the hotel's finances. The court, however, dismissed this claim finding that fiduciary duties did not lie where "the Management Agreement was the result of an arm's-length relationship between sophisticated business entities after negotiations and the parties clearly chose not to contract for a fiduciary relationship."[16] Thus, as in *M Waikiki LLC*, the court denied owner's assertion of a common-law right where the parties' management agreement provided for a contrary and more limited set of rights.

Damages are Nonetheless Available

Even if a court declines to enforce contractual limits on an owner's termination rights, a manager is nevertheless entitled to damages flowing from the owner's breach of the parties' management agreement.[17] Available damages could include:

- unpaid fees the manager would have collected for the duration of the contract term;
- reimbursable expenses;
- loss of working capital, loan, or other investments in the hotel;
- reimbursement of unamortized key money or other unamortized capital investment;
- damages resulting from ceasing business operations;
- damages to the manager's reputation with guests, vendors and other industry parties associated with sudden termination; and
- direct costs associated with re-entering the market in which the hotel is located.[18]

In addition to contract damages, a manager could seek tort damages for conversion of its property (*e.g.,* IP and confidential information), or alternatively, compensatory and punitive damages for wrongful eviction. Under New York law, wrongful eviction can give rise to treble damages.[19]

Conclusion

In conclusion, *Eden Roc II* represents the most significant hurdle to reinstatement should an owner resort to a self-help eviction otherwise precluded by the parties' management agreement. Any attempt to achieve court-

ordered reinstatement hinges on a trial court recognizing the flaws in *Eden Roc II*, including the First Department's misapplication of *Wien & Malkin LLLP* (arbitrator was justified in vacating termination based on contractual limitations) and the inapplicability of *Woolley* as California-specific, or alternatively, the superior persuasiveness of Md. Code Ann., Com. Law §§ 23-102(b) as a public policy matter. Irrespective of whether manager can succeed in reinstatement, however, manager would be entitled to all damages flowing from breach of the parties' management agreement.

NOTES:

[1]*Marriott Intern., Inc. v. Eden Roc, LLLP*, 104 A.D.3d 583, 962 N.Y.S.2d 111 (1st Dep't 2013) ("*Eden Roc II*").

[2]*See Marriott Intern., Inc. v. Eden Roc, LLLP*, 2012 WL 5451640 (N.Y. Sup 2012), aff'd in part, modified in part, vacated in part, 104 A.D.3d 583, 962 N.Y.S.2d 111 (1st Dep't 2013).

[3]*Eden Roc II*, 104 A.D.3d at 584.

[4]*Id.* at Comment A.

[5]*Wien & Malkin LLP v. Helmsley-Spear, Inc.*, 12 A.D.3d 65, 783 N.Y.S.2d 339 (1st Dep't 2004), order rev'd, 6 N.Y.3d 471, 813 N.Y.S.2d 691, 846 N.E.2d 1201 (2006).

[6]*Id.* at 72.

[7]*Id.* (arbitrator "exhibited a manifest disregard for the applicable agreements in finding that [owner] was bound to retain [manager] due to defects in the proxy procedure").

[8]*See Wien & Malkin LLP v. Helmsley-Spear, Inc.*, 6 N.Y.3d 471, 485, 813 N.Y.S.2d 691, 846 N.E.2d 1201 (2006).

[9]*Woolley v. Embassy Suites, Inc.*, 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (1st Dist. 1991).

[10]*Woolley* at 1533.

[11]*See* MD Fisc. Note, 2004 Sess. S.B. 603.

[12]No. 651457/2011 (Sup. Ct. N.Y. Cnty. Aug. 31, 2011) (Bransten, J.).

[13]Transcript of Hearing on TRO, M Waikiki LLC v. Marriott Hotel Services, Inc. et al, No. 651457/2011 (Sup. Ct. N.Y. Cnty. Aug. 31, 2011).

[14]Hours after the temporary restraining order was granted, Waikiki filed for bankruptcy. The dispute was removed to federal court in connection with this filing. According to legal periodicals, Marriott agreed to drop its suit (*i.e.* not seek reinstatement) and stop contesting Waikiki's Chapter 11 plan in return for Waikiki's payment of an undisclosed sum of money. The precipitating force behind settlement was the bankruptcy court's ruling that Marriott's proof of claim against Waikiki was properly valued at $20.66 million. *See* Sean McLernon. *Marriot Reaches Deal in Dispute Over $250M Honolulu Hotel* (*available at* http://www.law360.com/articles/357626/marriott-reaches-deal-in-dispute-over-250m-honolulu-hotel).

[15]Madison 92nd Street Assoc., LLC v. Courtyard Mgmt. Corp., No. 602762/2009 (Sup. Ct. N.Y. Cnty. Jul. 19, 2010) (Kapnick, J.).

[16]*Id.*; *see also Northeast General Corp. v. Wellington Advertising, Inc.*, 82 N.Y.2d 158, 160, 604 N.Y.S.2d 1, 624 N.E.2d 129 (1993) (courts look to parties' agreements "to discover, not generate, the nexus of relationship and the particular expression establishing the parties' interdependency").

[17]*See Marriott Intern., Inc. v. Eden Roc, LLLP*, 2013 WL 6506844, *4 (N.Y. Sup 2013) (damages available notwithstanding owner's power to terminate).

[18]*See* Jan A. deRoos & Scott D. Berman, *Calculating Damage Awards in Hotel Management Agreement Terminations*, 14 Cornell Hospitality Report 16, 6-16 (2014).

[19]*See* N.Y. RPAPL § 853 ("If a person is disseized, ejected, or put out of real property in a forcible or unlawful manner . . . he is entitled to recover treble damages in an action therefor against the wrong-doer.").