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

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With the increased likelihood that a New York court will enforce the negotiated scope of termination rights, a focus on clearly delineating those rights becomes more important than ever, including at minimum a clear statement in the hotel management agreement that the right to seek specific performance represents a material consideration for manager executing the agreement. The authors of this article explain.

In summer 2017, our *Real Estate Finance Journal* article, *Midnight Raid*,[1] analyzed the extent to which then-existing New York law enabled a hotel manager to enjoin termination of the parties' management agreement, and therefore self-help eviction by owner, on extra-contractual grounds. We highlighted two competing lines of cases on that point. The first, headlined by *Marriott Intern., Inc. v. Eden Roc, LLLP*[2] and steeped in the Restatement (Second) of Contracts,[3] viewed management agreements in blanket fashion as common law personal services contracts not amenable to injunction. Subject only to liability for damages, *Eden Roc II* empowered an owner to terminate and evict at any time and for any (or no) reason, despite specific contractual limitations to the contrary. The second, rooted in trial court precedent, viewed those bargained-for limitations as trumping owner's unfettered common law termination rights, and enforced that bargain against owner through appropriate injunctive relief. Unfortunately, for managers, as of summer 2017, persuasive trial court precedent notwithstanding, *Eden Roc II* rendered slim the chance of preventing termination even where the management agreement seemed to dictate that result. Fast forward to 2019 and a return to nuance and trial court discretion.

IHG Management (Maryland) LLC v. West 44th Street Hotel LLC

In *IHG Management (Maryland) LLC v. West 44th Street Hotel LLC*,[4] owner sought to terminate the parties' management agreement under *Eden Roc II*, "assert[ing] that the subject HMA also is a personal services contract and,

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therefore, [manager] is not entitled to Specific Performance."[5] After analyzing governing Maryland law (discussed at length in *Midnight Raid*)[6] that ensured manager's right to seek specific performance, the court addressed owner's personal services argument under *Eden Roc II*, concluding "the case did not stand for the broad stroked proposition that any and all HMAs are inherently personal services contract exempt from specific performance."[7] Instead, the Court upheld the parties' bargain as reflected in the management agreement (which "specifically contemplate[s] Specific Performance of the Agreement . . . stat[ing] the 'agreement may not be terminable at will' "), and rejected the "argument that the HMA is nevertheless entirely a personal services contract, exempt from specific performance and one that can be terminated at will."[8] Placing the freedom to contract and cannons of construction above broad-brush common law precedent, the court continued, "[i]f this Court were to hold that the HMA is one for personal services, incapable of being subject to specific performance, the Court would simultaneously be rendering those provisions in the Agreement which permit specific performance meaningless."[9] Accordingly, in a separate opinion, Justice Bransten held that manager had demonstrated a likelihood of success for purposes of preliminarily enjoining termination of the management agreement.[10]

On Appeal

On appeal, the First Department affirmed, holding that "the court did not improvidently exercise its discretion in granting plaintiff's motion for a preliminary injunction . . . to maintain the status quo until a determination was made as to whether plaintiff was in default of its obligations under the [hotel management agreement]."[11] By virtue of affirmance, New York trial courts appear authorized to reject *Eden Roc II* as barring specific performance across the board; rather, like Justice Bransten's decision below, trial courts may conduct a more nuanced analysis of, and specifically enforce if appropriate, the parties' contractual bargain, including to the extent it limits owner's termination rights. Importantly, *IHG Mgt.* further undermines *Eden Roc II*—specifically its reliance on Restatement (Second) of Contracts § 367—in deeming Maryland's statute presumptively constitutional and further rejecting the argument that "personal service contracts such as the HMA cannot be specifically enforced as a constitutional matter . . . because such enforcement violates the [13th] Amendment's prohibition against involuntary servitude."[12] To the contrary, the First Department noted, "owner voluntarily negotiated for and signed the contract,"[13] including application of Maryland law.[14] Thus, under the proper set of facts, *IHG Mgt.* empowers New York's trial courts to enjoin termination of a management agreement where necessary to enforce the parties' specific bargain, without fear of reversal based on *Eden Roc II*'s "broad stroked" application of the common law concept of personal services contract.

Conclusion

With the increased likelihood that a New York court will enforce the negotiated scope of termination rights, a focus on clearly delineating those rights becomes more important than ever, including at minimum a clear statement in the management agreement that the right to seek specific performance represents a material consideration for manager executing the

agreement. Further, managers should consider selecting Maryland law to govern their agreements, thereby benefiting from an added layer of statutory protection against extra-contractual termination and self-help eviction by owner, which events usually transpire before manager has recouped its upfront investment and/or forecasted ROI through the management fee stream.

NOTES:

[1]Yehudah L. Buchweitz and Matthew R. Friedenberg, *The Midnight Raid—Can a Hotel Manager Prevent Termination of its Management Agreement?*, The Real Estate Finance Journal, pgs. 51–55 (Summer 2017).

[2]*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*").

[3]As we previously wrote, under Restatement (Second) of Contracts § 367, "[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." *Midnight Raid* at 52 (internal quotations omitted).

[4]*IHG Management (Maryland) LLC v. West 44th Street Hotel LLC*, 2018 WL 1730840 (N.Y. Sup 2018), order aff'd, 163 A.D.3d 413, 81 N.Y.S.3d 401 (1st Dep't 2018).

[5]*Id.*

[6]As we previously explained in *Midnight Raid*:

> "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." *Id.* at 53 (internal quotations omitted).

[7]*Id.* at *2.

[8]*Id.* at *3.

[9]*Id.* (citing *Vermont Teddy Bear Co., Inc. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475, 775 N.Y.S.2d 765, 807 N.E.2d 876 (2004) (precluding courts from reading contracts in a manner that "excise terms")).

[10]*See IHG Management (Maryland) LLC v. West 44th Street Hotel LLC*, 2018 WL 1730843 (N.Y. Sup 2018), order aff'd, 163 A.D.3d 413, 81 N.Y.S.3d 401 (1st Dep't 2018).

[11]*IHG Management (Maryland) LLC v. West 44th Street Hotel LLC*, 163 A.D.3d 413, 414, 81 N.Y.S.3d 401 (1st Dep't 2018) ("*IHG Mgt.*").

[12]163 A.D.3d at 414.

[13]*Id.*

[14]*See Midnight Raid* at p. 53, noting that the legislative history behind the Maryland statute (Md. Fisc. Not, 2004 Sess. S.B. 603) made clear it was passed to reject *Woolley v. Embassy Suites, Inc.*, 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (1st Dist. 1991), a case cited approvingly in *Eden Roc II*, which "applied common law agency principles, rather than common law contract principles, to the legal relationships between hotel owners and operators."