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The Termination of Hotel Management Agreements

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It's midnight. Everyone at the hotel is sleeping. Suddenly, the hotel is surrounded by guards. Then construction workers. Every sign indicating the brand affiliation is removed. Menus, napkins and towels are all replaced. The sun rises. The hotel's workers are summoned to a conference room and fired. When executives from the hotel management company attempt to enter the hotel they have managed for the last five years and have a contractual right to manage for the next 40, they are barred from the property.

Does this sound like the plot of the next summer blockbuster? It's not. Rather, these are the facts of a series of recent cases in which owners of luxury hotels terminated their long-term hotel management agreements overnight in what has been described as the hospitality industry's version of a "coup d'état."[1]

In each case, the hotel manager was given no notice of any kind of default and no opportunity to cure. In each case, the failure to provide an opportunity to cure likely constituted a blatant breach of the hotel management contract by the owner. In each case, the hotel manager ran into court and attempted to obtain a preliminary injunction barring the termination and in each case, the hotel manager failed to prevent the termination of the contract notwithstanding the fact that one court found the conduct likely constituted a willful breach of contract.[2]

Given the structure of most hotel management agreements, unless a hotel management company has a present ownership interest in the hotel, courts routinely reject attempts to enjoin the termination of the management agreement. This article examines the issue.

Revocability

It is well-settled that hotel management contracts (and most real estate management contracts) are agency contracts,[3] containing all of the indicia of a principal-agent relationship; they grant the hotel manager the authority to: (i) bind the owner to contracts and other financial and legal obligations; (ii) purchase and procure goods and services for the hotel at the owner's expense; (iii) set the prices to be charged by the hotel; and (iv) control the revenues from the hotel.[4]

But because hotel management agreements are agency contracts, they are revocable at will by the hotel owner. "This principle of law is ancient and well-settled."[5] The reason for the rule is "that it is deemed contrary to public policy for a principal to have an agent forced upon him against his will."[6] As the court in the seminal case of *Woolley v. Embassy Suites* explained, "courts wish to avoid the friction and social costs which result when the parties are reunited in a relationship that has already failed, especially where the services involve mutual confidence and the exercise of discretionary authority."

Thus, "[e]ven in commercial and other business dealings a principal, at least generally, is permitted to revoke an agency when he pleases, even though he has contracted with the agent for a definite period of time, for the reason that it is deemed contrary to public policy for a principal to have an agent forced upon him against his will."[7] Accordingly, "[w]hen a hotel owner enters into a management agreement by which it divests itself of day-to-day control of the hotel's operation but retains ownership…the owner retains the right to revoke the managing agent's control."[8] However, where the principal terminates an agency contract prior to the end of the agent's contractual term in violation of the contract itself, the principal will be liable for damages, if any, for breach of contract.[9]

'Coupled With an Interest'

In the context of hotel management agreements, however, there is an exception to the general rule that such an agency relationship is revocable at will, where the hotel manager's agency is "coupled with an interest."

Specifically, when an agency contract is coupled with an interest (or as some courts describe it, given as security) in the subject matter of the agency (i.e., the hotel), the agency is irrevocable and the agent (here, the hotel management company) may be able to enjoin the termination of the agency contract.[10] This doctrine, first enunciated in *Hunt v. Rousmanier's Adm'rs*, 21 U.S. 174 (1823), by U.S. Supreme Court Justice John Marshall, provides that where, as part of its agreement with the principal, "the agent receives title to all or part of the subject matter of the agency," the agency will be deemed to be coupled with an interest and therefore irrevocable.[11]

For an agency to be coupled with an interest, the agent must have a "specific, present property interest" in the subject matter of the agency.[12] As the U.S. Court of Appeals for the Third Circuit has explained, "[a]n indispensable feature of a power given as security is that the agent have a proprietary interest in the res or subject matter of the agency independent of the agency relationship itself."[13]

Accordingly, in an agency coupled with an interest, "the agency relationship itself does not create the interest, the agency merely serves to protect the separately granted or created interest when the two are coupled."[14]

Application of the Exception

Relying on the agency with an interest exception, hotel management companies have routinely sought to enjoin the premature termination of their hotel management contracts by arguing that they have an interest in the hotel. However, courts around the country have rejected such arguments absent evidence that the hotel management company has a present, specific and identifiable ownership interest in the hotel itself.

For example, in *Woolley* the hotel management company (Embassy Suites) sought to enjoin the hotel owners' termination of several management contracts pursuant to which Embassy Suites managed a number of hotels. Among other things, Embassy Suites argued that the management contracts could not be terminated because they were coupled with an interest. Specifically, Embassy Suites argued both that (i) its entitlement to be paid a management fee, calculated as a percentage of the gross revenues earned by each hotel; and (ii) the fact that the hotels at issue were branded with Embassy Suite's name and reputation, gave it an interest in the subject matter of the agency.[15]

Relying on the rule that the agent have a present, specific and identifiable interest in the subject matter of the agency for the agency to be irrevocable, the *Woolley* court rejected both arguments. First, the court held that "[m]onetary compensation, in whatever form it may take, does not create a power coupled with an interest so as to make the agency irrevocable."[16] With respect to the argument that the hotels' branding with Embassy Suite's name constituted a qualifying interest in the subject matter of the agency, the court held that the interest "Embassy has in seeing the hotels succeed so as to enhance its reputation and prestige is not the type of specific, coexisting property interest necessary to constitute an agency coupled with an interest."[17]

Similarly, in *Government Guarantee Fund v. Hyatt*, Hyatt sought to enjoin the termination of its management agreement by the hotel owner of a hotel it managed on the island of St. John in the U.S. Virgin Islands. Hyatt argued that its agency should be deemed coupled with an interest because, by entering into the agreement to manage the hotel, it and the owner effectively created a new business. Hyatt argued that, in support of that new business, it made substantial contributions and capital investments in the hotel.

Specifically, Hyatt argued that it (i) lent the use of its registered trademarks and service marks to the hotel; (ii) provided proprietary software and reservation systems to the hotel; and (iii) made the hotel a member of the Hyatt worldwide chain of hotels and resorts. Hyatt further argued that it entered into the management agreement by which it would manage and control the day to day operations of the hotel to protect those contributions and to "protect and secure its economic interests in the new business."[18]

The court rejected these arguments, holding among other things that the manager's contribution of trademarks, trade names, chain services and management expertise "was merely a normal incident of an agency relationship, and did not create an irrevocable agency."[19]

In *Pacific Landmark Hotel v. Marriott Hotels*, the court refused to enjoin the termination of Marriott's management agreement for the management of the San Diego Marriott Hotel and Marina, even though the management agreement expressly provided that the agency was "coupled with an interest" and Marriott, through a subsidiary, obtained a 5 percent limited partnership interest in the owner of the hotel in exchange for over $20 million in loans secured by deeds of trust on the hotel.

Addressing Marriott's first argument, that the agency became irrevocable by virtue of language in the contract explicitly providing that Marriott's agency was coupled with an interest, the court held that "[w]here no specific present property interest has been found, the courts have consistently held the agency revocable…in spite of express declarations in the contract that it was coupled with an interest and irrevocable."[20] The court also found no merit to and rejected Marriott's argument that its 5 percent interest in the ownership of the hotel resulted in an agency coupled with an interest. Relying on the U.S. Supreme Court's 1823 decision in *Hunt*, the court held that because Marriott's ownership interest was held by a subsidiary, and thus in a different corporate entity than the entity that was the manager under the hotel management agreement, the agency was not coupled with an interest because the "power and the interest [were not] united in the same person."[21] Specifically, the *Pacific Landmark* court held that:

For business reasons, Marriott chose to have the Management Agreements drafted only between MHI and Owners. MHI was not given any interest in the Hotel via any other document evidencing loans to or investments in Owners. Marriott itself is not a named party to any of the agreements with Owners executed on Oct. 7, 1987. Instead, separately formed legal subsidiaries of Marriott…acquired interests in the Hotel by way of tax benefits, ownership in the Owners' partnerships and a trust deed on the Hotel in exchange for capital contributions and loans. We assume one of the purposes of these separate corporate entities was to insulate Marriott from liability.

The bottom line, however, is that neither defendants nor the court below could identify any "interest" of MHI in the hotel or point to any document involved in the transaction which memorialized such an interest, other than to assert MHI has an interest through "Marriott and its affiliates'" interests. Such, however, does not recognize the separate corporate entities to this business transaction.[22]

For that reason, the court held that, notwithstanding the ownership interest in the hotel owned by Marriott's subsidiary, Marriott did not have an agency coupled with an interest.[23]

Finally, in *2660 Woodley Road Joint Venture v. ITT Sheraton*, Sheraton attempted to enjoin the termination of the management agreement for the Sheraton Washington Hotel in Washington, D.C.[24] Sheraton argued its agency was irrevocable because, among other things, (i) a Sheraton subsidiary, Washington Sheraton Corporation (WSC), was a member of the joint venture that owned the hotel; and (ii) Sheraton entered into the management agreement to protect WSC's interest in the hotel. In fact, at the time Sheraton executed the management agreement for the hotel, WSC was a 50/50 member of the joint venture with John Hancock.

Just as in *Pacific Landmark*, the court rejected Sheraton's argument that the agency was irrevocable. Specifically, the court held that, even though the management contract and the joint venture agreement were entered into contemporaneously and the joint venture agreement specifically referenced the decision to enter into the management agreement, because the joint venture agreement did not reference Sheraton's agency at all, it did not support Sheraton's argument that WSC's interest was secured by the agency.

Further, the court held that because WSC had subsequently sold a portion of its stake in the joint venture to another party (leaving it with only a 1 [percent] interest in the joint venture) and did not have any management responsibility for the joint venture, the agency was revocable. Indeed, the court held that Sheraton could not "use a 1 [percent] interest to deny [the other members of the joint venture] the freedom to exercise their contractual termination rights and to choose management of their choice."[25] On these bases, the court denied Sheraton's motion for a preliminary injunction.

Conclusion

As the facts of the foregoing cases make clear, courts are loathe to find the existence of an agency coupled with an interest in the context of terminations of hotel management agreements, even where the agreements expressly provide that the agency is coupled with an interest and even where the management company actually owns a part of the hotel. This reluctance is likely based on the fundamental tenet, rooted in the Thirteenth Amendment's prohibition of slavery, "that specific performance cannot be decreed to enforce a contract for personal services, regardless of which party seeks enforcement."[26]

However, just because the agency is revocable does not mean a termination is without risk. Accordingly, both hotel owners and operators should proceed with caution and consult counsel before undertaking such a termination.

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Endnotes:

1. Report and Recommendations on Plaintiffs' Motion for Preliminary Injunction, *FHR TB v. TB Isle Resort*, No. 1:11-CV -23115, at (S.D. Fla. Sept. 26, 2011).

2. See, e.g., id.

3 See *Woolley v. Embassy Suites*, 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (1991) (holding that hotel management agreements constituted agency contracts).

4. Id.; see also *Lumbermans Mutl. Cas. v. Franey Muha Alliant Ins. Servs.*, 388 F. Supp. 2d 292, 302 (S.D.N.Y. 2005) (entering into contracts on behalf of another gives rise to principal-agent relationship).

5. *Ravallo v. Refrigerated Holdings*, 2009 WL 612490, at *4 (S.D.N.Y. 2009).

6. *Smith v. Conway*, 101 N.Y.S.2d 529, 531 (1950).

7. Id.

8. *PL Diamond v. Becker-Paramount,* 16 Misc. 3d 1105A, 841 N.Y.S.2d 828 (Sup. Ct. N.Y. Co. 2007).

9. *Wilson Sullivan Co. v. International Paper Makers Realty*, 307 N.Y. 20, 23 (1954) ("while [the principal] had the power to terminate at will its agency relationship with [the agent], if in so doing it violated its obligations under the contract, it must respond to plaintiff in damages"); see also *G.K. Alan Assoc. v. Lazzari*, 44 A.D. 3d 95, 102, 840 N.Y.S.2d 378, 385 (2d Dept. 2007) ("[a] principal is always free to terminate the agency relationship, subject to a claim for damages").

10. See Restatement of Agency (3d), §??3.12 (2006); *Hunt v. Rousmanier's Adm'rs*, 21 U.S. 174 (1823); *Ravallo v. Refrigerated Holdings,* 2009 WL 612490, *1 (S.D.N.Y. 2009).

11. *Peter Lampack Agency v. Grimes*, 29 Misc. 3d 1208A, 2010 N.Y. Slip Op. 517494 (Sup. Ct. N.Y. Co. 2010).

12. Id.; see also *Pacific Landmark Hotel v. Marriott Hotels*, 19 Cal. App. 4th 615, 23 Ca. Rptr. 2d 555 (1993); *Woolley v. Embassy Suites*, 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (1991).

13. *Government Guar. Fund of the Republic of Fin. v. Hyatt*, 95 F.3d 291, 301 (3d Cir. 1996).

14. Id.

15. *Woolley*, 227 Cal App. 3d at 1520, 278 Cal. Rptr. 719.

16. Id. at 1532, 279 Cal. Rptr. at 726.

17. Id. at 1533, 278 Cal. Rptr. at 726

18. *Government Guar. Fund*, 95 F.3d at 304.

19. Id. at 305.

20. *Pacific Landmark*, 19 Cal. App. 4th at 625-626 (citing *Capital Nat. Bank of Sacramento v. Stoll*, 220 Cal. 260, 30 P.2d 411 (1934)); see also *In re Jarmakowski's Estate*, 169 Misc. 463, 465, 8 N.Y.S.2d 35 (N.Y. Sur. 1938) ("[t]he words 'the intention hereof being to create an agency coupled with an interest' do not mean that it is an agency coupled with an interest. There must be more than mere words to establish this").

21. Id.

22. Id.

23. Id.

24. *2660 Woodley Rd. Joint Venture v. ITT Sheraton*, 1998 U.S. Dist. Lexis 22825 (D. Del. Feb. 4, 1998).

25. Id. at *11.

26. *Woolley*, 227 Cal. App. 3d at 1533-34, 278 Cal. Rptr. at 727.