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# The Precedents and the Principle

## An Update on Hotel-Management Agreements and the Laws of Agency

*by Michael C. Shindler*

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**A recent court decision emphasizes the following point: contract provisions notwithstanding, hotel management firms must vacate the premises if they are terminated.**

A decision issued in February by the U.S. District Court for the District of Delaware, in which a hotel-operating firm was unilaterally dismissed from a hotel property, has extended the reach of the holdings enunciated in three prior cases on this matter and has added Sheraton to the list of operating firms, joining Hyatt, Marriott, and Embassy Suites, whose management contracts have been revoked under agency law.[1] As described in my previous *Cornell Quarterly* article, the three earlier decisions confirmed the common-law principle that a principal always has the authority to terminate its agent, unless the agency is coupled with an interest, even in the face of potential breach-of-contract claims by the terminated agent.[2] In *2660*

[1] *Robert E. Woolley et al. v. Embassy Suites, Inc., et al.*, 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (Cal. App. 1 Dist. 1991); *Pacific Landmark Hotel Ltd. et al. v. Marriott Hotels, Inc., et al.*, 19 Cal. App. 4th 615, 23 Cal. Rptr. 555 (Cal. App. 4 Dist. 1993); and *Government Guarantee Fund of the Republic of Finland et al. v. Hyatt Corporation*, 95 F.3d 291 (3rd Cir. 1996).

[2] See: Michael C. Shindler, "The Principle of the Principal: An Examination of Hotel-Management Agreements and the Laws of Agency," *Cornell Hotel and Restaurant Administration Quarterly*, 38, No. 4 (August 1997), pp. 22–27.

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*Woodley Road Joint Venture v. ITT Sheraton*, the plaintiff delivered to the management firm a notice of termination of its management agreement for the 1,530-room Sheraton Washington Hotel.[3] The property, a convention hotel, has since been rebranded as a Marriott, which operates it. The owner is a joint venture owned by John Hancock Mutual Life Insurance Company (51 percent), Sumitomo Life Realty, Inc. (48 percent), and Washington Sheraton Corporation, a wholly owned subsidiary of ITT Sheraton Corporation (1 percent). The defendants, ITT Sheraton and another of its subsidiaries, Sheraton Operating Corporation (SOC), collectively known as the Sheraton Entities, together managed the property. Following the refusal of Sheraton Entities to quit the hotel and turn its operations back to the joint venture, the joint venture filed the complaint in this action. As occurred in the three previous similar cases, this complaint contained allegations of mismanagement on the part of Sheraton Entities and sought, among other things, an injunction ordering Sheraton Entities from the hotel. The opinion in this case resulted from the joint venture's request for a preliminary injunction.

The joint venture sought the preliminary injunction after Sheraton Entities refused to leave following receipt of a notice of revocation of its agency. The procedural requirements for obtaining an injunction do not permit a factual finding. Thus, for purposes of the complaint, there were no factual issues to be determined. The question turned instead on the power of a principal to terminate its agent, and whether the agent, that is, the Sheraton Entities, held an agency coupled with an interest.[4]

The Sheraton Entities put forth two theories to support its contention that it, indeed, should be viewed as holding an irrevocable agency. First, it pointed to the history of the formation of the joint venture. Originally, the joint venture was owned 50 percent by John Hancock and 50 percent by Washington Sheraton Corporation (WSC). The agreement for that venture acknowledged the contemporaneous execution and delivery of the management agreement with SOC. In fact, the original 1979 joint-venture agreement provided that the management of the joint venture was vested in both joint venturers, giving Washington Sheraton Corporation the right to veto any decisions of the joint venture. In 1985 WSC sold virtually all of its interest in the joint venture to John Hancock, leaving John Hancock in ownership of 99 percent of the joint-venture interests. In 1990 John Hancock sold an interest to Sumitomo Realty Life, and the joint venture was reconstituted to the form in which it existed at the commencement of the suit. The Sheraton Entities argued that

> ...the power granted by the joint venture in this case was held through SOC for the benefit of Sheraton and was given both (i) to secure the performance of John Hancock under the joint-venture agreement and (ii) to otherwise protect Sheraton's ownership in the hotel, which, at the time the relevant documents were negotiated, was a half-interest in the property.[5]

Sheraton Entities argued that it was so convinced of the irrevocability of the management agreement that it did not believe it necessary to address the issue in its '90 joint-venture agreement.

> Sheraton's agreement in the restated joint-venture agreement to relinquish any role in the management of the joint venture demonstrates Sheraton's total reliance on the irrevocability of the management contract as its only means, short of litigation, of protecting its remaining million-dollar investment in the joint venture.[6]

Sheraton Entities also cited the specific language of the *Restatement of Agency* to buttress its argument that ownership of an interest in the subject matter of the agency is not the sole means of creation of an agency power coupled with an interest. Section 138 of the *Restatement* states that

> ...[a] power given as security is a power to affect the legal relations of another, created in the form of an agency authority, but held for the benefit of the power holder *or a third person* and given to secure the performance of a duty or to protect a title, either legal or equitable, such power being given when the duty or title is created or given for consideration[7] [emphasis added].

The Sheraton Entities argued that, notwithstanding the ownership of the joint-venture interest in one entity, WSC, and the agency in another, SOC, the protection of WSC's interest in the joint venture confers on SOC, as agent for the benefit of WSC, the necessary interest to couple the agency and make it irrevocable.

The court had no sympathy for the Sheraton Entities' arguments. Favorably citing *Hyatt* as the law governing the case, the court set forth the principle of Section 118 of the *Restatement* that an agent's authority "terminates if the principal or the agent manifests to the other dissent to its continuance"[8] as a "well-established rule permit[ting] the revocation or termination of agencies at any time by either party, even where doing so constitutes a breach of contract."[9] In fact, the Sheraton Entities accepted *Hyatt* and the *Restatement* as the principles governing the case. It pinned its hopes on the argument of irrevocability. After examining both the 1990 joint-venture agreement and the management agreement, the court concluded that "SOC's agency was created for the benefit of the joint venture."[10] The court quoted from the management agreement the language it viewed as contradictory to the theory posited by the Sheraton Entities:

> In the performance of its duties as operator of the hotel, operator shall

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[3] *2660 Woodley Road Joint Venture et al. v. ITT Sheraton Corporation et al.*, Mem Opin., 97-450 JJF (U.S. Dist. Ct.–Del., Feb. 4, 1998).

[4] Shindler, p. 24.

[5] "Defendant's Memorandum in Opposition to Plaintiffs' Motion for Preliminary Injunction," filed November 7, 1997, in *2660 Woodley Road*, at 27.

[6] *Id.*, at 28.

[7] American Law Institute, *Restatement of the Law of Agency*, 2d ed. (St. Paul, MN: American Law Institute Publishers, 1958), § 138.

[8] *Restatement of the Law of Agency*, §118.

[9] *2660 Woodley Road*, at 4.

[10] *Id.*, at 6.

> act solely as agent of owner. Nothing herein shall constitute or be construed to be or create a partnership or joint venture between owner and operator. Owner acknowledges that this agreement is a management service contract which is irrevocable by owner except as herein set forth.[11]

Ruling that "this provision evidences agency authority...for the benefit of the [joint venture] and does not vest in SOC any power limiting the authority of the joint venture to terminate SOC's [management],"[12] the court looked to the joint venture for additional support for its decision. Citing the history of the joint venture on which the Sheraton Entities relied for its view of the rights of the parties, the court dismissed the Sheraton Entities' theory as follows:

> The current joint venture agreement provides that John Hancock and Sumitomo, not WSC, have the authority and responsibility for "[t]ermination...of the management contract or any other management contract or the rights, duties and obligations of the operator, any other operator or manager or the partnership thereunder." ...This provision expressly contemplates that SOC could be terminated by John Hancock and Sumitomo, for it alludes to the possibility of other management contracts and other operators or managers. Moreover, the joint venture agreement further provides that John Hancock and Sumitomo have the authority to select "an operator for the subject property [hotel] upon the expiration or earlier termination of the management contract and the entering into of a new management contract." ...Therefore, the court finds that because SOC has no interest independent from its agency powers under the management contract, [the Sheraton Entities'] agency theory must fail.[13]

The court also took the opportunity, in language perhaps unnecessary to the finding of a standard, revocable agency at issue in the case, to suggest that a *de minimis* interest is insufficient to vest an agent with irrevocable authority, saying

> "[n]either ITT or WSC may use a 1-percent interest to deny John Hancock and Sumitomo the freedom to exercise their contractual termination rights and to choose management of their choice."[14]

Concluding as it did that SOC's agency was revocable and, as a result, that the joint venture had a substantial likelihood of prevailing on the merits, the court moved to consider the other findings necessary for issuance of an injunction. The joint venture alleged several elements of irreparable harm, including **(i)** continuous trespass as an injury to real property, **(ii)** forced agency relationship, **(iii)** loss of goodwill and decline in group bookings (affecting value adversely), and **(iv)** delay in approval of a necessary renovation program.[15] The court found these arguments persuasive. Furthermore, having determined that the joint venture had satisfied the burden on the revocability of the management agreement (and the likelihood of success on that issue), the court readily adopted the joint venture's view that the Sheraton Entities' harm, if any was determined, was fully compensable in money damages and that the harm to the joint venture of continuing the *status quo* was more egregious. Having reached a conclusion on each of the first three elements in the joint venture's favor, the court negated the import of the "public interest," acknowledged that "as a practical matter, if a plaintiff demonstrates both a likelihood of success on the merits and irreparable injury, it almost always will be the case that the public interest will favor [the party seeking the injunction],"[16] and granted the joint venture's motion for preliminary injunction.

*2660 Woodley Road* does not break new ground or elaborate new principles of law. As such, it does not stand with the prior cases on which it is based as a pillar of principal–agency law. However, *2660 Woodley Road* is the first reported case to rest on those earlier holdings, and this case is the first reported case since *Hyatt* in which the owner was able to argue successfully for a preliminary injunction, the issuance of which was immediately effective in barring the operating firm from the property.[17] As a result of *Hyatt* and *2660 Woodley Road*, it is likely that hotel-management companies in these circumstances in the future will heed any notice of termination they receive and immediately vacate the premises.

Perhaps the most significant part of this ruling is the statement that *de minimis* ownership in an entity will be insufficient to vest an irrevocable agency in the agent. One can foresee that the next battleground in this area will be the determination of how large an ownership interest held by the management firm will be sufficient to cause a court to consider the possibility that the parties intended the agency to be irrevocable. Particularly interesting will be the negotiated statements of intent in management agreements and the venture agreements creating the owner (in which the manager will assuredly have an interest of some size) expressing the desires of the parties.

*2660 Woodley Road* thus stands as an extension of an old, but critically important, principle enunciated by *Woolley*, *Pacific Landmark*, and *Hyatt*, the three precedents to this case. Although it has been said that "a precedent embalms a principle," in this case, the precedents actually buried the agent. **CQ**

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[11] *Id.*, quoting Article VII of the parties' management agreement.

[12] *Id.*, at 7. The Court also found SOC's third-party argument and attempt to distinguish *Pacific Landmark* less than compelling, writing: "Like the instant case, the property manager was a separate affiliate, a corporation with an ownership interest whose agency was created by a separate written agreement with the owner. ...Further, the court finds the Third Circuit's analysis [described in *Hyatt*] in [*Pacific Landmark*] instructive." *Id.*, at 11 and 12.

[13] *Id.*, at 8 and 9.

[14] *Id.*, at 9. The court refers to the rights (perhaps "power" would be a more accurate term) arising under the joint-venture agreement, as the management agreement provides no "right" in the joint venture to terminate without cause (although the joint venture does allege "cause" in its complaint).

[15] "Plaintiff's Brief in Support of Motion for Preliminary Injunction," filed September 8, 1997, in *2660 Woodley Road*, at 18–21.

[16] *AT&T v. Winback and Conserve Program, Inc.*, 42 F2nd 1421, 1427 n.8 (3d Cir. 1984).

[17] The trial court in *Hyatt* issued an injunction ordering Hyatt from the hotel, then known as Hyatt Regency St. John. Hyatt's appeal to the Third Circuit delayed Hyatt's delivery of possession of the hotel to its owners for some time after the issuance of the injunction.