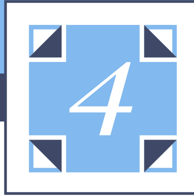

"The Owners are Coming, The Owners are Coming"

BY MICHAEL SHINDLER, PRESIDENT[1]

The question presented for this panel discussion is whether the so-called "Midnight Raid" can be prevented. The legal talent represented on the panel (that is, those for whom being a lawyer continues as part of their professional responsibility) will explore the cases[2], articles[3], commentaries and impacts, as only attorneys can.

For this paper, it is not important whether a Management Agreement creates an agency, an independent contract, a personal services contract or some other form of fiduciary relationship[4]. In most Management Agreements, regardless of the relative sophistication of the parties in attempting to name the relationship so created, the Management Agreement ordinarily creates a relationship based on the following principles:

- Party A ("Owner") contracts with Party B ("Manager") to operate BlackRock Hotel ("BlackRock") on behalf of Owner.

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[2] Just so there is no question that the author actually was once a lawyer, here are the cases reviewed in advance of writing this piece. Marriott International, Inc., et al. v. Eden Roc, LLLP, 104 A.D.3d 583, 962 N.Y.S.2d 111 (2013) (herein, Eden Roc); Transcript of Proceedings dated October 26, 2012 (herein, Eden Roc Transcript); Brief for Fairmont Raffles Hotels, International, Inc., et al. as Amici Curiae Supporting Respondents, at Marriott International, Inc., et al. v. Eden Roc, LLLP, 104 A.D.3d 583, 962 N.Y.S.2d 111 (2013) (herein, Eden Roc Amicus Brief); FHR TB, LLC v. TB Isle Resort, LP., 865 F. Supp. 2d 1172 (S.D. Fla. 2011) (herein, Fairmont); RC/PB, Inc. v. The Ritz-Carlton Hotel Company, LLC, et al., Case No. 50202011CA010071XXXXMB, 15th Judicial Circuit, FL, 2013 [Unpublished Order]; 2660 Woodley Road Joint Venture et al. v. ITT Sheraton Corporation et al., 369 F. 3d 732 (3rd Cir. 2004); Government Guarantee Fund of the Republic of Finland et al. v. Hyatt Corporation, 95 F. 3d 291 (3rd Cir. 1996); Pacific Landmark Hotel Ltd. et al. v Marriott Hotels, Inc., et al., 19 Cal. App. 4th 615, 23 Cal. Rprt. 555 (Cal. App. 4 Dist. 1993) (herein, Pacific Landmark); 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) (herein, Woolley)

[3] And, here are the articles. William A. Brewer III and Alexander D. Widell, "Hotel Wars Come to New York: Deciding Disputes Over Management Agreements," New York Law Journal, Vol. 250, No. 2 (July 3, 2013); James S. Renard and Kristi Motley, "The Agency Challenge: How Woolley, Woodley, and Other Cases Rearranged the Hotel-management Landscape," Cornell Hotel and Restaurant Administration Quarterly, Vol. 44, No. 3 (June 2003) (herein, Renard/Motley); Michael C. Shindler and Donald A. Shindler, "Slicing the Rebate Pie, A Discussion and Suggestion", LODGING, Vol. 26, No. 4 (December 2000); Michael C. Shindler, "The Precedents and the Principle: An Update on Hotel-Management Agreements and the Laws of Agency," Cornell Hotel and Restaurant Administration Quarterly, Vol. 39, No. 3 (June 1998); 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, Vol. 38, No. 4 (August 1997) (herein, Principle). Even a partially observant reader might note that, with two exceptions, the author either wrote or co-wrote them.

[4] However, it is important that the scenarios presented here will not result in the Holy Grail of management positions, the elusive "Agency Coupled with an Interest". What it is has been defined but never found, discussed but never agreed, and its internal characteristics are themselves the subject of debate and less-than-clear elaboration by distinguished jurists (see Woolley and Pacific Landmark) and at least two commentators (see Principle, 24-25; Renard/Motley).

- Owner expends *beaucoup bucks* [5] (Euros, Pounds, Rupies, Won, Dirhams, Loonies, RMB, etc.[6]) to build or buy BlackRock and turns its operation over to Manager.
- Manager obtains for itself – with Owner's affirmation by the terms of the Management Contract – certain authority to run BlackRock according to the dictates of the Management Agreement and, usually in the circumstances giving rise to a Midnight Raid, Manager's "brand standards"[7].
- Manager creates and submits to Owner the annual operating budget, the annual marketing plan, and the annual (in some cases, three years forward and, in some cases, five years forward) capital/FF&E improvement/replacement plan).
- Manager controls the setting of rates, selection of employees, employment policies (including wages, salaries, benefits programs, work rules, work schedules, etc.), marketing and sales programs, menus for F&B outlets and banquets/catering, and policies and procedures ranging from how to clean the ash urns, to how the beds are made, to what radio station the appropriate device is set to (and to the specification for the device), etc.
- Manager also controls the bank account(s) established in Owner's name to operate BlackRock (that is, receive revenues and pay expenses), pay the employees, anticipate replacements of FF&E and capital items, and, of course, to pay its own management fees and other appropriate billable items (e.g., centralized services, reservations, etc.).
- Manager reports on a regular basis, mandated by the Management Agreement, on the performance of BlackRock.
- Owner may have consultative or, even, approval rights over some or all of these items, though, ordinarily, Owner does not.

The debate over the name of this relationship continues in the cases.[8] Does it matter? This author posits that it does not.[9] Somehow, fiduciary relationships such as that created by the litany of matters described above[10] might tend to give rise to the series of events that follows:

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[5] I am firmly of the belief that this should become a defined industry term of art.

[6] This recitation of currencies is designed to show that the author recognizes that the hotel industry is international. It is not designed to suggest that the legal principles at stake are necessarily applicable in countries where the text of laws is written in characters that go right-to-left or up-and-down or is based on something other than common law (particularly, Louisiana, the author's place of birth). Basically, I went through my little bag of foreign currencies at home, and these were present.

[7] This is not to suggest that the only instances a Management Agreement is signed are with branded management; rather, the literature (see n.2 and n.3, supra) has not reported cases where a third-party manager is involved.

[8] Note particularly the transcript from Eden Roc and the rather odd disposition to this point of that case on appeal.

[9] Add to n. 4 the State of Maryland. At the urging of a very large hotel company headquartered there, the Maryland legislature overrode the common law of Agency by allowing contracting parties to deny any agency relationship in contracts. See Md. Code Ann., Com. Law § 23-101, et seq. This probably has helped that company, along with several REITs based there, to address contractual relationship matters by reference to Maryland law. This note is intended to suggest that I have no earthly idea whether the characterization of the owner-manager relationship matters in Maryland.

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- Owner determines for some reason (or, even, no reason at all) that it no longer wishes to be in contractual entanglement with Manager regarding BlackRock.
- Owner sends11 notice of default and/or termination, and Manager either (a) denies default or (b) responds that termination is not warranted or appropriate, and (c) stands its ground.
- Owner swoops in during the night (hence, the name, "Midnight[12] Raid") and dislodges[13] Manager from its involvement in BlackRock. [14]
- One of the parties to the Management Agreement sues the other.

Clearly, this has happened, in this or similar form, all too many times, with enough of the major hotel companies[15] to suggest that it will happen again.

This brings us back to the question *du jour*. This author does not believe that the Midnight Raid is wholly preventable. However, parties to a Management Agreement for BlackRock could do the following (or their respective counsel can advise these items):

- Owner could insist on approval rights over the hiring of the General Manager, the Director of Finance, and the Director of Sales & Marketing (or positions holding those responsibilities). A truly aggressive Owner would add the Director of Human Resources and the Director of F&B, and the most aggressive Owner would include the entire Executive Committee.
- Owner could insist on weekly meetings among the General Manager, the Director of Finance and Owner's designated Asset Manager, along with weekly flash reports of operations.
- Owner could insist on meaningful monthly operating meetings (to take place within a few days of delivery of the monthly operating statement (the "few" being the minimum time it would take for Owner to properly review the monthly operating statement)) on an Owner-prescribed agenda, where Manager would require

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[10] The author acknowledges that he has just characterized the relationship as "fiduciary", a term rife with legal meaning. Sorry, I do not know how else to do this.

[11] But, see Fairmont.

[12] One can surmise that "2:30 AM Raid" just doesn't have the same ring to it; one can almost always surmise, however, that these things occur in the darkness (literal and figurative) of the early morning, rather than at midnight.

[13] This is hardly a legal term deserving of its own footnote, but I liked the pun.

[14] It is important to note that a manager can also terminate the Agreement if it no longer wishes to serve as manager and take the darkness of night to debrand and depart, however, this paper addresses the Midnight Raid, not the Midnight Retreat.

[15] Reasonable people may differ on the list of "major" hotel companies, but I would include Marriott, Starwood, Hilton, Hyatt, InterContinental, Wyndham, Carlson (Radisson) and Fairmont Raffles (and all their progeny). There may be others on this list, but these, generally speaking, are the big ones. I am not aware of any cases involving a Wyndham brand (almost all franchised hotels), Hilton brand or an IHG brand; all the others have found themselves on the wrong end of a (broadly speaking) "Midnight Raid" or a lawsuit terminating their management agreements.

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appropriate department heads (or assistants) to be available for presentations of the operations of all departments in BlackRock.

- Manager (and/or Owner, as well) could insist that all written communications between Owner and Manager are conducted between Owner and the General Manager and, critically, a designated person (the Regional Manager or similar position) from Manager's oversight group.
- Manager would (and should) keep track of all Owner communications, including those outside of regular and prescribed channels; this would include emails, notes of conversations, and any directives provided by Owner outside of the appropriate channels of communications.[16]
- Approval rights on budget matters should be clearly stated (and understood) and followed to the letter by both parties.
- Manager should – even if it is not technically obligated to do so – report unusual occurrences quickly and timely to Owner and share its action steps to deal with them with Owner when feasible.
- Manager must educate Owner about existing brand initiatives, forthcoming brand initiatives, the rationale behind them and how they will benefit BlackRock and provide value to Owners. The days of saying "it's a brand standard" should be left in the past.
- Owner should insist upon, and Managers should provide, a clear statement of the substance and costs of so-called "centralized services".
- The parties should foster a collaborative relationship between the General Manager and the Owner's asset manager.
- Consider whether a termination by right provision ought to be included. Manager will howl about predictive values and continuity,[17] while the fee for such an "easy" right of termination should be tantamount to punitive to Owner.[18]
- If Manager is concerned about the ability of Owner to fulfill damages claims[19], Manager should seek a partial or complete guaranty or provide an agreed measure of liquidated damages.[20]
- The parties should negotiate clear provisions on the use and ownership of guest data,[21] particularly when dealing with one of the majors with multiple brands.

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[16] In one particularly troubling relationship some time ago, the author and his team maintained such a log that became several accumulated loose-leaf binders organized according to which provisions of the management agreement the owner breached. At an arbitration following the certain-to-have-occurred termination, the owner was found liable for (and ultimately paid) a multi-million dollar award, due in large measure to the showing of an ongoing pattern of owner interference.

[17] See Eden Roc Amicus Brief, 12-13 (and, see Badour Aff. ¶10); see also Fairmont, 865 F.Supp.2d at 1179.

[18] Yes, I understand how challenging on both sides this negotiation would be. I did not promise complete practicality or practicability.

[19] See Eden Roc Amicus Brief,13

[20] See n. 17.

[21] The author prefers the approach of shared ownership with significantly restricted use by the Owner.

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- The parties should address self-dealing provisions, such as purchasing fees, singlesource suppliers, volume discounts and advertising and marketing support from vendors.

These are just some suggestions. They will not prevent the Midnight Raid, but they may make the clear delineation of fault and default and, therefore, the measure of damages, a bit more daunting. It should be pointed out that no publicly-reported case has gone all the way to a damages award for either an owner or a manager. This author submits that both owners and managers likely fear the results of such a determination. Any such determination significantly favoring a manager's claim to damages would likely lessen, if not blunt, any proclivity of an owner to risk a large damages award (except for a singlepurpose, non-bankruptcy remote entity); on the contrary, a determination of damages favoring an owner (that is, accepting an owner's evaluation of a manager's damages), even if the owner is ordered to pay, might actually bolster the argument made by the amici in Eden Roc and Fairmont, in Fairmont. The "litigation explosion"[22] stemming from the "Midnight Raid" is not over. As long as there are long-term management agreements and disappointed owners, the hotel industry will wrestle with these matters for the foreseeable future.

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[22] Renard/Motley, 76.

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