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## How secure is your hotel management agreement?

A hotel operator enters into a long-term hotel management agreement with the owner of a hotel and pays its lawyers thousands of dollars to ensure that the agreement cannot easily be terminated by the owner. The agreement contains the customary protections for the operator, including provisions that limit the owner's right to terminate only (a) in the event of a material default by the operator (and in such case, only after notice and a generous cure period); or (b) if the operator fails certain "performance tests" contained in the agreement, which everyone (including the owner) recognizes are almost impossible to fail.

Can the operator be comfortable that in the event of a future dispute between the owner and the operator, a court would uphold the provisions of that management agreement that prevent the owner from terminating the agreement? A recent court case (*FHR TB, LLC, et. al., v. TB ISLE RESORT, L.P.*) involving the Fairmont Turnberry hotel in Aventura, Florida, suggests that the answer to that question is probably no.

In 2005, Fairmont Hotels and Resorts entered into a hotel management agreement that gave Fairmont the exclusive right to operate the Turnberry resort for up to 50 years. The agreement was favorable to Fairmont, and expressly provided that the only basis for termination of the agreement by the owner of the hotel was a "material default" by Fairmont.

Nevertheless, on Aug. 28, 2011, after years of disagreements with Fairmont, the hotel owner entered the premises without notice, and informed Fairmont that it was being terminated as the hotel manager, effective



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immediately. The hotel's security guards, with guns in their holsters, physically escorted the Fairmont personnel off the premises.

In removing Fairmont, the hotel owner took the position that it had the power to terminate Fairmont as the manager not because of any alleged default by Fairmont, but because the management agreement created a revocable agency relationship between the owner and Fairmont whereby the owner, as principal, always has the power to terminate its agent.

Fairmont, on the other hand, took the position that the owner's actions constituted bad faith and were a blatant breach of the provisions of the management agreement. Furthermore, Fairmont alleged that its agency relationship was "coupled with an interest" and thus irrevocable, due to the fact that Fairmont had a right of first offer and right of first refusal with respect to the hotel.



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Fairmont sued and asked the judge to reinstate Fairmont, on the basis that the owner's actions could only be remedied by requiring the owner to take back Fairmont as the operator of the hotel.

The judge sided with the owner and rejected Fairmont's request for reinstatement, concluding that the hotel management agreement created a revocable agency relationship. The court closely analyzed Fairmont's claim that the agency should be treated as an irrevocable agency, but the court ultimately determined that the rights of first offer and refusal held by Fairmont were not sufficient to cause Fairmont's agency to be treated as "coupled with an interest" and thus irrevocable.

The judge acknowledged that the termination of the management agreement by the owner might give rise to a claim for monetary damages if the termination was determined

to be a wrongful breach of contract. However, the judge held that even if there had been a wrongful breach, the court did not have the power to legally force the owner to accept Fairmont as the manager of its resort on a going-forward basis.

While the court's decision in Turnberry may be alarming to hotel operators, the judge in Turnberry simply invoked the well-settled law of agency that has applied for many years to hotel management agreements. That is, unless a relationship between a hotel owner and its manager is "coupled with an interest," such that the manager has a real and present property interest in the hotel, the owner generally has the power to terminate that agency relationship, even if the express language in the management agreement provides otherwise. In such case, the operator's recourse may only be a right to sue for monetary damages, if the termination is deemed to be a wrongful breach of contract.

The Turnberry case demonstrates the need for a careful review of not just the contractual provisions of a hotel management agreement, but also the nature of the agency relationship between the owner and manager of a hotel. As noted above, there are instances where it may be possible to structure the relationship between the owner and manager in such a way that the agency is "coupled with an interest," and thus treated as irrevocable. In any event, it is important to understand the nature of the revocable versus irrevocable agency relationship at the outset so as to avoid surprises, as may have been the case for Fairmont as it was being escorted by armed personnel off the Turnberry premises.