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Robert H. Wilson

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## **HOTEL MANAGEMENT CONTRACTS: BREACH OF CONTRACT, TERMINATION, AND DAMAGES**

**Robert H. Wilson**

### **ABSTRACT**

Recent court decisions have redefined the relationships and expectations of both owners and operators involved in hotel management contracts. What were once considered irrevocable contracts that a court would enforce with an order for specific performance are now likely to be contracts that can be revoked (but which may carry the risk of damage awards). This paper looks at contract law and examines several interesting hospitality court cases to determine the types of damages that would be available in the event a court determines that a management contract has been breached.

### **Introduction**

A hotel management contract is a detailed contract containing the rights and obligations of the hotel owner and the rights and obligations of the operating management company hired to manage the hotel. All aspects of the operation and management of the hotel—including renewal terms, management fees, payment of expenses and operator expenses, renovations, operating budgets, financial reporting, operator's duties, termination rights, and length of contract—are some of the issues that are addressed in the typical hotel management contract (Eyster, 1988). In addition, many management agreements usually provide that the contract is irrevocable and cannot be terminated without cause. Generally, management contracts provide that either side is barred from terminating the contract before its term is expired unless the other party somehow breaches or violates the terms of the agreement.

A series of court cases continues to define the power of owners to terminate existing hotel management contracts, notwithstanding clauses contained in the agreements prohibiting early termination. The cases are *Wooley v. Embassy Suites* (1991); *Pacific Landmark v. Marriott* (1993); *Government Guarantee Fund of Finland v. Hyatt Corporation* (1995) and (1998); and *2660 Woodley Road Joint Venture, Woodley Road Associates, Inc., John Hancock Mutual Life Insurance Company, and Sumitomo Life Realty, Inc. v. ITT Sheraton Corporation and Sheraton Operating Corporation* (1998). A quick reading of these cases may lead one to assume that a hotel owner may make an early termination of a management agreement and suffer no adverse consequences. I encourage the reader who is not familiar with these cases to review several interesting articles that have been written on the topic. Michael Shindler (1997), James Eyster (1997), and Robert Wilson (1999) are some examples of such studies.

While the law is evolving, the courts clearly point out that while an owner may have the power to terminate or revoke an existing hotel management agreement without

cause, the owner runs the risk of breaching the contract. Major issues or questions that were not resolved by the cases (and which will be discussed in this article) are the types of remedies and types of damages that would be available if either the management company or the owner terminates the agreement without cause prior to the end of the agreement.

## Review of Case Law

The following cases focus on the rights and powers of owners to terminate existing management contracts by applying existing definitions and interpretations of the laws of agency.

### *Wooley v. Embassy Suites*

In *Wooley v. Embassy Suites*, 227 Cal. App. 3d 1520, 278 Cal Rptr. 719 (1991), Robert Wooley and Charles Sweeney were partners who owned 22 hotels. Embassy franchised all the hotels and managed 17 of them under 17 separate management contracts. The management agreements provided for termination of the management contracts only in the event of a breach of contract by either party, after notice of termination, with a right to cure the breach by the operator, and with arbitration. Wooley attempted to terminate the contracts of 9 hotels by delivering notices of default, alleging that Embassy had "materially breached the management contracts by making expenditures in excess of budget allocations" (p. 1525). Embassy obtained a preliminary injunction in a lower court enjoining Wooley from terminating the management contracts pending a resolution of arbitration to determine whether Embassy had breached the contracts. Wooley argued that he had the right to terminate because Embassy was an agent of Wooley, and that an agent's continued employment can be revoked at any time.

While the court found that Wooley could terminate the management contract at any time, there was a warning about the consequences of the termination. The court stated that while the "principal has the power to revoke an agent's authority at any time before the agent has completed performance" (p. 1529), the "agent's remedy for wrongful termination is damages, as in any other breach of contract law" (p. 1530). "The principal's power (to terminate the contract) is absolute and applies even if doing so is a violation of the contract or the agency is characterized as 'irrevocable'" (p. 1531, Rest. 2d Agency, sec 118, com. B., p. 300). The courts indicate in these cases that even though the party who terminates a management contract without cause has the power to terminate, a breach of contract may still result.

The court ruled that hotel management contracts are personal service contracts, and that the rule against specific performance applies. (Specific performance will be discussed later in this article.) The Wooley case left unanswered one significant question: if an owner terminates a hotel management contract without cause, what are the damages that the hotel owner can be forced to pay for the wrongful termination? (Issues involving "agencies coupled with an interest" and the power to revoke will not be discussed in this article.)

### *Pacific Landmark v. Marriott*

In *Pacific Landmark v. Marriott* (1993), the California court clarified some of the unanswered questions from the *Wooley* case. Pacific Landmark owned a hotel on land it leased from the San Diego Port District. Pacific entered into a series of contracts with Marriott International (at that time a wholly owned subsidiary of Marriott Corporation) and San Diego Hotels, Inc. (a wholly owned subsidiary of Marriott Corporation) in October, 1987. Two of the contracts were management contracts allowing Marriott International to become the manager of the two identical hotel towers standing side-by-side on the shore of the San Diego Bay.

On December 3, 1992 (subsequent to the ruling in the *Wooley* case), the owners sued the defendant Marriott companies and sought damages for breach of the management agreements. On December 31, 1992, the Landmark gave notice to Marriott International of the breach of the agreement, along with its intention to terminate the management agreements on January 31, 1993. Marriott International refused to leave the hotel, claiming that the contracts were irrevocable.

The court stated, using the *Wooley v. Embassy Suites* case as precedent, that "even if a hotel management contract did attempt to restrict the power of the owner to terminate the manager, such provision would be ineffective unless the agency were coupled with an interest, because the principal's power of revocation is absolute and applies even if doing so is a violation of the contract or the agency is characterized as 'irrevocable'" (p. 625). Again, as in the *Wooley* case, the court found a principal agency relationship existed, that no agency coupled with an interest existed, and found that the owners had the power to revoke the management contract. The court also noted that when an owner exercises the power to revoke an existing management contract, it may still be breaching the agreement and subjecting itself to damages for breach of contract.

No decision was rendered as to whether the revocation was a breach of contract, as the case was sent back to the lower court. The parties eventually settled the case without the court resolving the issue of breach of contract and damages owed.

### *Government Guarantee Fund of Finland v. Hyatt Corporation*

In the case of *Government Guarantee Fund of Finland v. Hyatt Corporation* (1995) and (1998)—a case originally heard in the District Court of the Virgin Islands—the court again considered the question of the validity of a revocation of a hotel management contract that had been originally intended by the parties to be irrevocable. The Government Guarantee Fund of Finland became the owner of the property as part of a bank bailout of Skopbank (the original lender). The Government Guaranty Fund of Finland ultimately sold the property to 35 Acres Associates.

On March 21, 1995, and again on June 8, 1995 (the *Wooley* case was decided in 1991 and the *Pacific Landmark* case was decided in 1993), 35 Acres Associates wrote to Hyatt, stating: "GGF, Skopbank, and 35 Acres consider the Management Agreement between

Hyatt Corporation and Great Cruz Bay Development Company, Inc. as void, terminated, and/or expired." On June 8, 1995, 35 Acres demanded that Hyatt "immediately surrender possession of the Hotel " to 35 Acres. The owner, 35 Acres Associates, filed suit and Hyatt filed a counterclaim. On appeal, the court said "the parties agree that this appeal focuses only on 35 Acres' power to terminate the agency and its right to possession of the hotel and related property, as well as transition matters, irrespective of the ultimate result of the remaining litigation. Thus we do not consider whether 35 Acres wrongfully terminated Hyatt's management rights" (p. 297). Hyatt argued that 35 Acres did not have the power to revoke the contract because the parties intended the contract to be irrevocable by creating an agency coupled with an interest.

In discussing the applicable law, the court, quoting the Restatement of Agency, states:

The principal has the power to revoke ... although doing so is in violation of a contract between the parties and although the authority is expressed to be irrevocable. A statement in a contract that either party cannot terminate the authority is effective only to create liability for its wrongful termination. The only exception to the rule that principals may terminate an agency relationship at any time is when the authority granted to the agent is a power given as a security" (p. 300).

The court said that whether agency contracts can be revoked or are irrevocable is a matter of law. Even if the parties intend to create an irrevocable agency, one coupled with an interest, they must, in fact, create the agency coupled with an interest. If they have not created a valid agency with an interest, the principal (owner) retains the power to revoke the agency. If the revocation is "contractually unjustified" (p. 307), the court may order that damages be paid.

***2660 Woodley Road Joint Venture, Woodley Road Associates, Inc., John Hancock Mutual Life Insurance Company and Sumitomo Life Realty, Inc. v. ITT Sheraton Corporation and Sheraton Operating Corporation***

In this case, 2660 Woodley Road Joint Venture, hereafter called "Joint Venture," owned a large convention hotel which it leased to Woodley Road Associates, Inc. ("Woodley Road"), a wholly owned subsidiary of John Hancock Mutual Life Insurance Company ("John Hancock"). The defendant, Sheraton Operating Corporation ("SOC"), is a wholly owned subsidiary of defendant ITT Sheraton Corporation ("ITT"). SOC managed the hotel for Woodley Road pursuant to a management contract that was signed in 1979. The management contract expired in the year 2000 but also contained rights to extend for three ten-year periods. The joint venture agreement provided that both John Hancock and Sumitomo would agree on major decisions. John Hancock and Sumitomo agreed to terminate the management contract and the agency of SOC. SOC refused to leave the property and contested the right of John Hancock and Sumitomo to terminate the management contract. As part of their suit, the plaintiffs filed a motion for a preliminary injunction asking the court that the defendant SOC be ordered out of the property before the court heard the rest of the case.

The court reiterated the reasoning that was used in the *Wooley v. Embassy Suites*, *Pacific Landmark v. Marriott*, and *Government Guarantee Fund of Finland v. Hyatt Cor-*

poration cases. Both parties had stipulated that the issue is a question of agency law. The court found that "an agent's authority terminates if the principal or the agent manifests to the other dissent to its continuance. This well-established rule permits the revocation or termination of agencies at any time by either party, even where doing so constitutes a breach of contract" (p. 4). "The only exception to this rule is when the authority granted to the agent is a 'power given as a security'" (p. 5). The court followed the reasoning used in the other cases to establish that a power given as security did not exist, that the agency was revocable.

A careful reading of these four cases reveals the courts' thinking and reasoning. They are reluctant to change one of the basic tenets of agency law: an agency relationship can be revoked by the principal (hotel owner), thereby terminating an existing management contract. However, this revocation may be a breach of the contract and may subject the hotel owner to a damage claim for wrongful termination or breach of contract. The courts are more willing to allow a revocation of the contract and to order damages to be paid to the management company than they are to force the performance of personal services contracts. The courts will allow a management contract to be irrevocable under certain limited conditions when the courts determine that an agency coupled with an interest exists.

The cases are all clear on one point: most hotel management contracts create a principal/agent relationship where the hotel owner is the principal and the hotel operator is the agent of the owner. The laws of agency define, modify, and regulate the rights and obligations that the parties have agreed upon in the management agreement. Many hotel management contracts may be terminated without cause by either the owner or the operator, and contract law will be used to determine remedies and damages if the termination is wrongful. While many courts have rendered decisions providing for damage awards for breach of contracts, much of the uncertainty in the hospitality industry exists because the courts have not yet determined what remedies are available in the event of an early termination without cause of a hotel management agreement.

### **Remedies for Breach of Contract**

The Restatement of the Law of Contracts is the basis upon which courts render decisions to compensate parties involved in a contract where one or more of the parties have breached the terms of the contract. Even contracts that create a principal/agent relationship and are controlled by the laws of agency look to contract law in determining remedies for a breach of the agency contract.

The Restatement of Contracts (sec 345) provides the following possible judicial remedies for a judgment involving a breach of contract:

1. Awarding a sum of money due under the contract or as damages;
2. Requiring specific performance of a contract or enjoining its non-performance;

3. Requiring restoration of a specific thing to prevent unjust enrichment;
4. Awarding a sum of money to prevent unjust enrichment;
5. Declaring the rights of the parties; and
6. Enforcing an arbitration award.

A court can order more than one of these remedies. The court will order enforcement of the contract, either by ordering one of the parties to pay monetary damages, or, in some cases, ordering specific performance. Sometimes a court will order restitution, "requiring a party to restore a specific thing that is in his hands, or the court may order restoration or make restoration a condition of granting relief to the other party" (Restatement, sec 345, p. 109).

An injured party has the right to damages for a breach of contract. The types of damages available are that which is necessary to make the other party whole, or the amount necessary to put the person in the same position that they would have been in had there been no breach of contract. This is commonly referred to as the expectation interest. The loss that is sustained as a result of the breach is the loss in value. If there is no performance, the loss of value will be equal to the value that the performance would have had. If there is partial performance, the difference between the value of the performance if there had been no breach less the value of the partially performed acts are the measure of damages for loss of value. The Restatement sec 347 provides that an injured party has a right of damages based upon its expectation interest as measured by:

- a. The loss of value to him of the other party's performance caused by its failure or deficiency; plus
- b. Any other loss, including incidental or consequential loss, caused by the breach, less
- c. Any cost or other loss that he has avoided by not having to perform.

It should be noted that the rules pertaining to damages owed can be limited by provisions in contracts that specify the amount of money that one side will owe the other if a breach of contract occurs (called liquidated damages). Liquidated damages will be discussed in more detail later in this article.

"The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation to the promisee for the loss resulting from breach. 'Willful' breaches have not been distinguished from other breaches, punitive damages have not been awarded for breach of contract, and specific performance has not been granted where compensation in damages is an adequate substitute for the injured party" (Restatement of Contracts, Chapter 16, introductory note, 1979). Courts generally attempt to put a party in as good a position as it would have been in had the contract been performed as promised.

The following are excerpts from Sec 351, "Unforeseeability and Related Limitations on Damages":

"Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made."

"Loss may be foreseeable as a probable result of a breach because it follows from the breach:

- a. in the ordinary course of events, or
- b. as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know."

"A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation."

"A contracting party is generally expected to take account of those risks that are foreseeable at the time he makes the contract. He is not, however, liable in the event of breach for loss that he did not at the time of contracting have reason to foresee as a probable result of such a breach" (Notes, sec 351, p. 135).

Foreseeability is an objective test—that is, foreseeability is what a reasonable person would normally have reason to foresee. The fact that either party did not foresee a particular type of loss does not preclude the injured party from recovering. The concept of foreseeability in a breach of contract context is similar to the results in the Uniform Commercial Code sec 2-714, where a loss that results from a breach in the ordinary course of events is foreseeable as the probable result of the breach. (The reader should note that service contracts such as hotel management contracts are not covered by the Uniform Commercial Code.) The damages that an injured party may be entitled to receive for the type of loss that results in the ordinary course of events are often called general damages. If the loss that occurs is not in the ordinary course of business, then no recovery is allowed unless the breaching party knew or had some reason to know of the particular type of loss.

A breach of an agreement frequently results in claims made by third parties not a party to the contract against the injured party. For example, the management company may have signed contracts involving security, accounting, maintenance, laundry, etc. with other third parties (including subsidiaries). "The party in breach is liable for the amount of any judgment against the injured party together with his reasonable expenditures in the litigation, if the party in breach had reason to foresee such expenditures as the probable result of his breach at the time he made the contract. This is so even though the judgment in the litigation is based on a liquidated damage clause in the injured party's contract" (p. 138). It is foreseeable that if a contract is breached, other people may sue who have been injured by the breach. The resulting injuries to those third parties are normally foreseeable, and will create additional liability to the breaching party.

An injured party suffers a loss when it is unable to obtain a substitute for the goods or services that it expected would be provided by the breaching party. If it is foreseeable

that an injured party will not be able to obtain a substitute arrangement, the resulting loss may be recovered (when, for example, a management company wrongfully breaches its contract, and the hotel owner is not able to hire a suitable replacement).

### **Nominal Damages**

It is also possible that a breach of contract occurs and the injured party suffers no loss or minimal loss as a result of obtaining alternate services at a lower price or that are more beneficial than the original contract. The party would be entitled to receive what are called nominal damages. Sometimes, however, an injured party takes reasonable steps to minimize losses but is unable to do so. The injured party would be able to recover the full amount of his losses. Incidental losses are those losses incurred to avoid loss and are also recoverable.

As an alternative to some of the measure of damages just discussed, an injured party has a right to damages that "include expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed" (Restatement of Contracts, sec 349, p. 124).

Contracting parties may agree as part of their contract that if either party substantially breaches the contract, the breaching party will be obligated to pay an agreed upon sum. The contracting parties agree ahead of time as to the amount of the damages that the breaching party will be responsible to pay to the other. Commonly referred to as liquidated damages, the parties agree to limit the damages payable or recoverable to a certain, fixed amount. Each party limits its risk for breach of contract to the agreed-upon amount. Liquidated damages will be discussed in more detail later on.

### **Limitations on Damages**

The court must be able to determine with reasonable certainty the amount of the loss of value. Sec. 352 of the Restatement of Contracts states that "damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty." The ability to calculate the amount of lost profits and other losses is extremely difficult to ascertain when the contract calls for performance over an extended period of time. Typical management contracts can run from six months to five or ten years with certain rights to extend for even longer periods of time. A long length of time left in the contract and very complex business arrangements can make determining the amount of loss or lost profits a very difficult and complicated matter, even with the help of expert witnesses. Anyone who has ever had to make a ten-year forecast of future hotel revenues, expenses, profits, occupancy levels, room rates, utility costs, interest rates, renovation costs, etc. knows that it is extremely difficult to be precise with any degree of accuracy. "If a business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs, or prices, proof will be more difficult. Damages may be established with reasonable certainty with the aid of expert testimony, economic and

financial data, market surveys and analyses, business records of similar enterprises, and the like" (Restatement of Contracts, sec 352, Notes, p. 146). One of the great uncertainties that face either side in this type of complex litigation (and the reason that so many of these cases are settled) is that each side will produce damage estimates that vary widely.

Whether the court would determine that lost profits estimated to occur for 5 to 15 years in the future can be estimated with "reasonable certainty" is a potential pitfall for hotel operators attempting to recover for losses when a hotel management contract is wrongfully terminated. Another open question would be whether the court would allow damages to be considered for time periods beyond the original contract term that would occur during option periods.

### **Mitigation of Damages**

The damages that an injured party may collect are limited to its actual loss that results from the breach. In addition, a party to a contract is under the obligation to mitigate or lessen its losses after a breach of contract. The party cannot sit idly and do nothing to minimize losses. In fact, the party has an obligation to take reasonable steps to minimize the losses that will be sustained. Sec 350 of the Restatement of Contracts, p. 126, states that "damages are not recoverable for loss that the injured party could have avoided without undue risk, burden, or humiliation. The injured party is expected to take action to make 'substitute' arrangements. An injured employee is expected to seek work elsewhere. If the employee fails to seek alternate employment, the amount of damages recoverable will be reduced by the amount that the employee could have earned. The party who has breached the contract must be able to show that the substitute arrangement was available. Damages will not be reduced, however, if the injured party is unable to obtain 'substitute' arrangements. The injured party is not precluded from recovery by the rule stated to the extent that he has made reasonable but unsuccessful efforts to avoid loss" (sec 350, Restatement of Contracts, p. 126).

Many unanswered questions remain as to how this rule would apply to a situation where a hotel owner terminates a management contract. How would the court interpret whether an injured party has made "reasonable but unsuccessful efforts to avoid loss"? What obligation would the management company have to attempt to "substitute" the loss of profits by arranging to manage another similar property in the same market? For what period of time would the injured management company need to seek the "substitute" arrangement? It appears that if the original contract ran for 10 years, the management company would be obligated to seek "substitute" arrangements that would be for the same time period as the original contract. (One should remember that the injured management company would seek lost profits covering a time period well into the future, including option periods.)

Can one determine what a court would consider to be a "substitute" arrangement? The notes on the Restatement of Contracts, sec 350, par. E, p. 130, indicate, "Whether an available alternative transaction is a suitable substitute depends on all the circumstances, including the similarity of the performance and the times and places they would

be rendered. If discrepancies between the transactions can be adequately compensated for in damages, the alternative transaction is regarded as a substitute and such damages are awarded." Would a management company be obligated to attempt to manage other properties that might not be similar but are in the same market in order to mitigate damages? It is clear that the injured management company might have a difficult time collecting substantial damages for a breach of management contract unless it takes substantial action so that a court would be satisfied that it has met its burden to mitigate damages.

If the injured party is able to successfully obtain a "substitute" arrangement, the potential damages are reduced. The notes on the Restatement of Contracts uses an example that shows that if a person "makes an especially favorable substitute transaction, so that he sustains a smaller loss than might have been expected, his damages are reduced by the loss avoided as a result of that transaction" (Note 12, sec 346, Restatement of Contracts, p. 116).

### **Punitive Damages**

Punitive damages are the type of award to the injured party that is intended to punish the behavior of the other party. Damages in contract cases are usually awarded to compensate an injured party for its loss. Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable (Restatement of Contracts, sec 355, p. 154). Punitive damages are sometimes awarded in tort cases where the action by one party is so aggravated, willful, intentional, or against public policy that the courts decide to send a message to punish the behavior and to discourage others from the same type of behavior. "The common-law rule, to which there were limited qualifications and exceptions, stated simply that punitive damages may not be assessed in an action for breach of contract, no matter what the circumstances of malice, abuse, wantonness, or oppression that attended the breach" (Sherry, p. 177). As a result, contract cases do not usually give rise to awards of punitive damages unless the behavior is also a tort for which the injured party could recover.

### **Termination Rights Included in Agreement**

Hotel management agreements may contain provisions that provide for termination rights for either or both parties to the contract. The termination option may arise from any occurrence agreed to in the contract. For example, the owner is sometimes granted the right to terminate management contracts upon the occurrence of the operator's breach of contract, the operator's willful misconduct or fraud, the operator's bankruptcy, the operator's failure to provide chain services, or for poor operating performance (with operator's right to cure). (*Hotel Investments*, Rushmore, p. A3-56, 1997.) The termination of the contract resulting from any of the stated occurrences may or may not give rise to damages from a breach of contract. For example, a termination resulting from the breach of contract would clearly allow the owner to sue for damages. A provision allowing for

owner termination caused by "negative earnings events" may not give rise to a default and damages. (*Hotel Investments*, Rushmore, p. A3-56, 1997.)

The management contract may also provide for early termination without cause at the election of the owner. A typical clause of owner termination without cause might read as follows:

If this Agreement terminates pursuant to Owner's election, Owner shall pay to Operator liquidated damages, representing the agreed, reasonable stipulated sum of all losses suffered by Operator because of such termination (including, without limitation, home office and key hotel personnel commitments and loss of profits), in an amount equal to three (3) times annual fees and charges payable to Operator in the Fiscal Year ended immediately prior to the date on which Owner gives a termination notice to Operator. (*Hotel Investments*, Rushmore, p. A3-58, 1997.)

It is becoming more prevalent in the hotel industry to make an owner's right to terminate without cause a part of the management agreement. "For contracts negotiated between 1993-1996, 23% of hotel management contracts permit the owner to terminate the operator after a predetermined number of years. Termination fees are usually negotiated as a multiple of the most recent 12 months' management fee. For chain operators, this multiple ranges from 2 to 4 times the management fee depending on the length of the contract's term." (*Hotel Management Contracts in the U.S.*, Eyster, p. 29, 1997.) At the same time, this also means that of all management contracts negotiated between 1993-1996, fully 77% did not contain provisions allowing for early termination without cause. It is clear that, given the recent court cases allowing for owner termination, more owners and more operators must provide for early termination without cause with the payment of some agreed-upon sum. It should be noted that provisions contained in contracts allowing for termination without cause with a payment of an agreed-upon sum are contract rights that do not give rise to any claims or payments for default or breach of contract. They are, in fact, options to terminate, whereby the operator agrees that an owner may terminate the contract early by paying an agreed-upon sum. The termination that results is not caused by a breach of contract. These negotiated provisions for early termination should be distinguished from liquidated damages provisions in contracts.

### Liquidated Damages

With liquidated-damage provisions, both parties may agree, at the time of signing the contract, how much will be paid or received if the contract is breached. The parties agree in advance upon the amount of money that will be paid as damages for breaching the contract.

A liquidated-damages provision "liquidating" the damages is merely agreeing in advance what either or both parties will pay if the other party breaches the agreement or materially defaults. With such a provision, the courts save time, and each party saves time and money because what must be proved in court is only whether the contract has been breached. If the contract has been breached, the court will refer to the contract to

determine the amount of damages to award. Both parties also know in advance what a breach of contract will cost them. A liquidated-damages provision, if large enough, discourages either party from breaching the contract, or encourages both parties to perform under the terms of the contract. If too small, a liquidated-damages provision may encourage a party to breach a contract that is not providing the rewards expected.

The amount of liquidated damages must not be punitive in nature, but must be an attempt to compensate the injured party for the breach of contract. The amount must be some approximation of the amount of lost profits, or it could conceivably be set aside as being unconscionable. Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty (Restatement of Contracts, sec 356, p. 157).

### **Specific Performance**

Specific performance is an attempt by the court to produce the same result that full performance without a breach would have produced. The order forces the breaching party to perform the obligations of the contract. A court may also order a party to refrain from doing a certain act. "Specific performance of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty" (Restatement of Contracts, sec 357, p. 163). While specific performance is available in all breach of contract actions, courts usually hesitate before ordering it, especially where the contract is a personal service contract.

The court refused to order specific performance in all of the hotel cases discussed earlier. If damages can be awarded that will provide adequate relief, then the court will order that damages be paid, but will not order specific performance. Sec 359 of the Restatement of Contracts states that "specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party." If the award of damages is shown to be adequate compensation, then specific performance will not be granted. The Uniform Commercial Code does allow specific performance relating to the sale of goods. Hotel management contracts are contracts for the provision of services, not goods, and do not fall under the purview of the Uniform Commercial Code.

The courts must decide if money damages provide complete and adequate relief. Damage awards are usually considered to be adequate unless there is difficulty proving damages with reasonable certainty, difficulty in procuring a suitable substitute performance by means of money awarded as damages, or the likelihood that an award of damages could not be collected (Restatement of Contracts, sec 360, p. 167). If damages that might be awarded are not adequate, then the court will see fit to order specific performance. "Typical examples include heirlooms, family treasures, and works of art that induce a strong sentimental attachment" (Restatement of Contracts, sec 360, p. 167). Failure to deliver items that are unique, that cannot be easily substituted, or that cannot be

compensated by money will be more likely to result in orders of specific performance. The courts will specifically enforce contracts for the sale or lease of land and buildings because they are considered to be unique. Another interesting provision of the Restatement of Contracts is that specific performance can still be awarded in contracts that provide for liquidated damages in the event of a breach.

Of more importance is the fact that "specific performance or injunction will not be granted if the act or forbearance that would be compelled or the use of compulsion is contrary to public policy," or where the "character and magnitude of the performance would impose on the court burdens in enforcement or supervision that are disproportionate to the advantages to be gained from enforcement and to the harm to be suffered from its denial" (Restatement of Contracts, sec 365, p. 180, and sec 366, p. 182). In addition, "A promise to render personal service will not be specifically enforced" (Restatement of Contracts, sec 367, p. 184).

In *Government Guaranty Fund of Finland v. Hyatt Corporation*, District Court of the Virgin Islands, Civil Action No. 1995-68, P303 (1995), the courts refused to order specific performance. The courts followed the Restatement of Contracts in reaching their decision. "There are a variety of reasons why courts are loath to order specific performance of personal services contracts. Such an order would impose upon the court the prodigious if not impossible task of passing judgment on the quality of performance. It would also run contrary to the Thirteenth Amendment's prohibition against involuntary servitude. 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. Finally, it is impractical to require judicial oversight of a contract which calls for special knowledge, skill, or ability." It is quite clear that a court will not order specific performance of the typical hotel management contract unless the operator (agent) is considered to be an agent coupled with an interest.

The courts have also stated fairly clearly what contractual arrangements and agreement would have to exist in order for a management contract to be considered as an agency coupled with an interest. The creation of an agency coupled with an interest would allow a hotel management agreement to be enforced by a court order of specific performance. Both owners and operators are now able to determine with more certainty whether agreements will or will not cause an agency coupled with an interest to be created. See the articles by Shindler, Eyster, and Wilson for interesting discussions of the evolving question of exactly when an agency coupled with an interest might actually exist.

## **Conclusion**

Recent court decisions have redefined the relationships and expectations of both owners and operators involved in hotel management contracts. What were once considered irrevocable contracts that a court would enforce with an order for specific

performance are now likely to be contracts that can be revoked—but which may carry the risk of damage awards.

The following cases were reviewed in this article: *Wooley v. Embassy Suites* (1991); *Pacific Landmark v. Marriott* (1993); *Government Guarantee Fund of Finland v. Hyatt Corporation* (1995) and (1998); and *2660 Woodley Joint Venture, Woodley Road Associates, Inc., John Hancock Mutual Life Insurance Company, and Sumitomo Life Realty, Inc. v. ITT Sheraton Corporation and Sheraton Operating Corporation* (1998). Although the facts in each of the cases are obviously different, there are some fundamental similarities with each of the cases and with each of the court decisions. The similarities provide a strong clue as to what the courts will consider in future cases involving termination of hotel management contracts and the awarding of damages.

The courts in each of the cases have determined that the hotel management contract creates a principal agency relationship that is subject to the laws of agency. Agency law allows the principal (hotel owner) to revoke the agency relationship (the management contract) at any time unless the relationship is considered to be an agency coupled with an interest. In each one of the cases, the existing management contract was revoked. The management company in each of the cases argued that the management contract could not be revoked, as the agency was an agency coupled with an interest. In deciding against the management companies in each of the cases, the courts found that given the specific facts of the cases, an agency coupled with an interest did not exist. The owners therefore had the power to terminate or revoke the management contracts. At the same time, the courts in each of the cases state very clearly that even though the owners may have the power to revoke, they may not have the right to revoke. That is to say that they may have wrongfully terminated the management contract and be subject to damages in contract law. Each one of the cases was settled by the parties after the courts determined that the owner could lawfully revoke the management contract. As a result, the courts never had the opportunity to decide in any of the cases whether a breach of contract did exist and what damages might be payable.

The purpose of this article is to look at contract law to determine the types of damages that would be available in the event that a court determines that a management contract has been breached. If the court were presented with a case involving the wrongful termination of a management contract, the court would consider the following available remedies: awarding a sum of money due under the contract or as damages; requiring specific performance of a contract or enjoining its non-performance; requiring restoration of a specific thing to prevent unjust enrichment; awarding a sum of money to prevent unjust enrichment; declaring the rights of the parties; and enforcing an arbitration award.

Damages might include actual damages and consequential damages so that the wronged party would be made whole or put back in the same situation that it would be in if the contract had been performed as promised. The court would also consider the

suitability of specific performance, mitigation of damages, liquidated damages provisions, and buy-out provisions.

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Robert H. Wilson is an Associate Professor of Real Estate, Finance, and Law in the Department of Hotel, Restaurant & Travel Administration at the University of Massachusetts, Amherst.