
Hotels and leisure

Key terms for hotel management agreements Issue 7 – Liability and indemnities

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This is the seventh in a series of short briefing notes identifying key issues for discussion when agreeing the terms of a hotel management agreement (the HMA). In this briefing, we look at the allocation of liability between the hotel owner and the hotel operator; and the role of insurance in this context.



Introduction

The appointment of a hotel operator is in effect the handing over of control of the operation of the hotel owner’s business and assets to the hotel operator. The starting point to this is often a clear statement in the hotel management agreement that the hotel operator is to manage as it sees fit. This management right is then typically limited by a combination of

- Approval rights (for example, most hotel management agreements will provide for consultation and approval rights in respect of the annual budget).
- Exclusions (for example, a well advised hotel owner would seek to ensure that a hotel operator is not entitled to issue and conduct legal proceedings on behalf of the hotel owner in relation to certain matters).
- Limitations (for example a well advised hotel owner would seek to ensure that there are limitations on expenditure above certain levels unless provided for in a pre-agreed budget).
- Consent requirements (for example, a well advised hotel owner would seek to ensure that consent of the hotel owner is required where a hotel operator wishes to appoint or replace the general manager of the hotel).
- Reference to brand standards where the hotel is to be branded (which will set out the standards to which the hotel will be managed, noting that well advised owners try to ensure these are not too wide).

Subject to approval rights, exclusions, limitations, consent requirements and brand standards (all of which will need to be understood, negotiated and agreed to ensure that the hotel owner can exert some control over the operation of the hotel), the running of the hotel including the handling of finances, business strategy, service provision and personnel management is placed in the hands of the hotel operator.



The hotel owner's position

If the management of a hotel is placed in the hands of the hotel operator (subject to the items mentioned above), it may appear commercially unbalanced that despite retaining a high degree of control over all elements of the running of the hotel; the hotel operator will then require an indemnity from the hotel owner for any claims, damages or liabilities brought against the hotel operator as a result of their position as operator of the hotel (typically other than to the extent of the hotel operator's wilful misconduct or gross negligence).

In addition, it is likely that the hotel owner will be asked to waive any liability of the hotel operator in respect of the results of the actions or conduct of hotel employees which cause damage or loss to the hotel owner notwithstanding that it is the hotel operator who has arranged for them to be hired and whose chosen general manager will supervise and direct the hotel employees. Hotel owners will routinely and sensibly query how can this position be justified.



The hotel operator's position

Hotel operators will remind owners that the relationship between a hotel operator and hotel owner is a business management outsourcing arrangement and not an outsourcing of risk. The hotel operator is hired for its experience in running hotels and not as form of insurance policy. The appointment of the hotel operator should not mean that the hotel owner no longer takes on the risk (and importantly, the rewards) of ownership of the asset (if this is the commercial intention then a lease arrangement would be more appropriate).

Generally, the standard required of the hotel operator is limited to the hotel operator doing what it has contractually agreed to do but not being responsible for the outcome of operation. For example, the hotel operator should have appropriate hiring procedures (and these can be fine-tuned in the management agreement (with the relevant approval rights, exclusions, limitations and consent requirements) and then must adhere to those procedures; but the hotel operator should not be responsible if a hotel employee hired by in accordance with the agreed hiring principles and appropriate standards acts contrary to their contractual duties and causes loss to the hotel.



Negotiation considerations

- If the hotel owner is to continue to take business risk, then an appropriate compromise is that liability should fall upon the hotel operator when it fails to comply with the provisions of the management agreement and if there is misconduct or negligence.
- There is no doubt that thousands of hours have been spent by lawyers negotiating whether “misconduct” should instead be “wilful misconduct” or “negligence” should be “gross negligence”. Parties need to look at the governing law of the management agreement and current case law to determine what meaning these words have in the context of the document/transaction (as not all jurisdictions will recognise distinct differences between such phrases).

- Hotel operators should be liable for breach of contract (many standard forms of agreement attempt to restrict this only to circumstances where the operator has acted with some degree of negligence or misconduct). There is little justification for such an attempt, and it is arguable that to insist upon such a provision makes a mockery of having a detailed agreement with carefully drafted contractual obligations; if to be held liable for non-compliance with such provisions requires an assessment based on the laws of negligence as opposed to identifying simply whether or not the contractual obligations that the parties have spent time negotiating have been adhered to.
- Insurance will play an important role in relation to the removal (or mitigation) of many of the risks allocated to the hotel owner for which the hotel operator is indemnified. It is important to ensure that the management agreement is clear as to who should procure the insurance and the relevant parties that will be covered by it.



Conclusion

Hotel owners and hotel operators should focus their efforts on ensuring that a clear framework exists to balance the discretion of the hotel operators with the need or desire for the hotel owner to retain a realistic degree of active or passive control. Indemnity and liability provisions are complex and require careful consideration in the context of the commercial deal that has been done (and the way it has been legally documented). There is no point of being able to point on the one hand to a clear obligation on a party to do something (or not do) something; if elsewhere it is not clear whether there is liability for failing to do (or not doing) that thing.

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