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Maryland law defines management obligations

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NATIONAL REPORT—A new law in Maryland stating that the terms of the operating agreement govern disputes between management companies and owners might change the way business is conducted in the state.

SB 603 Commercial Law went into effect Oct. 1 and applies to any active hotel or retirement community operating agreement that follows Maryland law. Under the new law, when courts are asked to interpret contracts, they will follow common law of contracts

rather than common law of principal and agency.

According to Peter Ripin, attorney with Davidoff Malito & Hatcher LLP in New York, Maryland has leveled the playing field with the law.

"Previously, some other state courts had decided that the relationship between hotel owners and operators was similar to an agency relationship and that the operator, as agent, owed a fiduciary duty to its principal, the owner," Ripin said. "This resulted in the possibility of huge punitive damage awards against operators who allegedly breached their fiduciary duties, and also permitted owners to terminate long-term management agreements."

Bill Bosch, litigation partner with Katten Muchin Zavis Rosenman in Washington, however, said the law of principal and agency protects owners by mak-



Ripin

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Bosch

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ing the agent or management company obligated to disclose all of the compensation received, to put the interests of the principal or owner ahead of its own interests and to operate the hotel for the account of the owner.

"The conflict arises because the [larger management companies] are interested in promoting their brands and interested in maximizing top-line revenue, whereas owners are looking at individual assets and are trying to maximize the bottom line," Bosch said.

The statute attacks important, but unstated fiduciary duties that give an owner leverage with the management company, he said.

"Brands that decide to impose a new chainwide service may not improve profitability at an individual hotel," he said. "The brand says, 'But it sure does promote interest in our brand so the owner pays for those services even if we can't demonstrate the financial benefit to you.' And that problem gets compounded when manage-

ment companies don't fully disclose the nature of the fees they are charging because they control the books of the hotel and pay themselves out of hotel operating accounts."

Smaller third-party management companies, such as Salisbury, Md.-based Marshall Management, with about 12 contracts in Maryland, aren't as concerned. "The statute takes some of the gray area out of the contract," said Mike Marshall, president. "It changes the conceived argument that the contractee has."

Marshall said the statute seems to be geared toward brand management and franchisee agreements more than third-party management agreements.

"Maryland seems to be trying to get rid of frivolous lawsuits," said Marshall, whose company also has 25 contracts at hotels outside of Maryland.

Gary Williams, president and owner of Greenbelt, Md.-based Coakley & Williams Hotel Management Co., said if his company acts in good faith, there shouldn't be a need to consult the law.

"We've never had an issue with an owner saying we've misused funds or taken funds," he said.

The company has three of its 25 contracts in Maryland. Williams doesn't anticipate the statute affecting future agreements.

Marshall and Williams said management contracts usually follow the law of the state in which the property is located.

"If there is a dispute, the owner wants to be able to fight it in his own state so he doesn't have to travel," Marshall said. "I try to get Maryland law, but the management-company market is very competitive. If I try to fight for something like that, I'd lose the contract—even before the statute came out."

Thumbs up

Marriott International, which is headquartered in Maryland, and Starwood Hotels and Resorts Worldwide, which is incorporated in the state, issued statements of support for SB 603, but declined to comment for this article.

In a letter to Maryland Sen. Brian Frosh, Kenneth Siegel, executive v.p. and general counsel, Star-

wood, said: "The proposed bill represents a simple solution to a vexing problem. ... It will mean that [major hotel] operators can focus on their real businesses—providing the best service possible to their guest—rather than worrying about being second-guessed for every decision that they make."

Marriott released a similar statement made by Michael D. Schecter, senior counsel for the company at the time of the proposed legislation. In it, he said, "Without a statute to vary this common law rule, an operator has no ability to continue operating under the contract and risks lengthy and costly litigation to obtain even an inadequate monetary remedy."

Ripin recognized operators' concerns.

"Without this statute, owners had an incentive to litigate because if they could convince a judge that their garden-variety dispute with their operator was really an egregious breach of fiduciary duty, they stood to recover large punitive damage awards and the ability to terminate a long-term management agreement that they no longer wanted," Ripin said.

Dave Weymer, managing director and general counsel of Annapolis, Md.-based Thayer Lodging Group, which owns about 20 hotels, said the law is relevant.

"Without specifics, manager and owner relationships ebb and flow," he said. "With difficult times in the last three years, there's a propensity to become more aggressive. When things are better, people feel better about contracts."

Weymer said he will keep this law in mind as new agreements develop.

Bosch said all owners should evaluate their contracts.

"You have to anticipate that Maryland is merely the first in what may be a broader initiative by management companies to roll back fiduciary duties and shift the balance of power," he said.

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