

Hospitality Law

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Hotel Owners Confront Managers

The continuing economic slump and the steady decline in profit margins has resulted in hotel owners paying more attention to the way in which their hotels are managed and, specifically, to the management fees and other charges paid to the management chains operating their hotels. Over the past few months, operator Marriott International Inc. ("Marriott") has been the target of several law suits alleging, among other things, that Marriott overcharged for goods and services it received from third party contractors while pocketing the difference; accepted bribes from suppliers in turn for contracting with such suppliers to provide goods and services to Marriott managed hotels; failed to disclose relevant financial data regarding certain managed hotels; committed fraud; made intentional and negligent misrepresentation and breached common law covenants of good faith and fair dealing. Whereas previously, similar disputes and wrangling between hotel managers and owners often settled quietly, some are now finding their way to arbitration or the courtroom. These lawsuits, together with similar lawsuits commenced against Hilton Hotels Corp., Starwood Hotels & Resorts Worldwide Inc. and Hyatt Hotels Corp., demonstrate a new willingness on the part of hotel owners to openly and publicly challenge the practices of the hotel management companies operating their hotels.

At the centre of these claims is a concern by hotel owners that hotel operators are overcharging owners for services provided to a hotel or for reimbursable expenses and keeping much of the excess for corporate overhead or to improve the operator's brand name recognition. Specifically, owners feel that incentives or other funds paid to operators from certain purchasing entities or other suppliers to the hotel are being retained by the hotel managers rather than being passed along to the owners. For example, one of the allegations made against Marriott in a lawsuit commenced last May by CTF Holding Inc. (which owns approximately 60 Marriott-branded hotels), is that a contractor supplying audiovisual services overcharged the hotel and gave at least \$1.7 million to Marriott.

These disputes are a sign of the growing tension between managers and hotel owners which appear to be directly related to the heavy losses facing the hospitality industry due to the lagging economy and the September 11th terrorist attacks. Marriott has settled one of such disputes with Host Marriott Corporation ("Host"), the owner of 110 Marriott-managed hotels. However, as part of such settlement Marriott entered into new management agreements with Host in which it reportedly agreed to give Host a greater share of hotel profits and to reduce both its incentive fees and the amount of corporate overhead that Marriott can charge back to Host.

THE UPDATE

There are several implications of the recent disputes to the future relationships and negotiations between owners and managers:

- Owners have begun to pay more attention to their hotel management agreements. In particular, the practices of participating in an operator's purchasing programs, reimbursing operators for certain costs and expenses incurred by an operator, including the overhead associated with employees of the operator who spend time on matters specifically relating to an owner's hotel, are being re-evaluated.
- There is a re-consideration of what charges may be reasonably passed on to the owner for corporate overhead and brand recognition.
- Both owners and lenders who are underwriting hotel loans are showing increasing concern with the ways in which hotel operators are preparing financial statements with respect to a particular hotel. The integrity of hotel audits is being re-evaluated in a similar fashion to the way accounting firms are re-assessing the integrity of their own processes and procedures. Hotel owners are growing more anxious about their own audit rights and access to information regarding their properties.

In the short term, management chains will be under significant pressure to reduce their fees and provide hotel owners with a greater share of profits and access to information. According to various industry insiders, the shift in negotiations is moving in favour of the owners and managers will have to be cognisant of this trend and mindful of the growing concerns of owners and their desire to be more involved in the day-to-day operations of their properties. Referring to the lawsuit by Strategic Hotel Corporation against Marriott, a Marriott spokesperson suggested that the claim may be "something of a ploy to better position its portfolio for sale". The growing number of claims and the allegations being made indicate a more fundamental evolution in the relationship between hotel owners and managers.

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