

# How Hotel Managers Might Protect Themselves From Early Termination

**Joshua Stein**

*You can't completely eliminate the risk, but if the market allows,  
you might mitigate it with some creative deal structures.*



**IN A SERIES** of cases over the last decade or so, the courts have sometimes allowed a hotel owner (an “Owner”) to terminate a hotel manager (a “Manager”) under a long-term management agreement (a “Contract”), even when the Contract does not allow early termination (an “Early Termination”).

How have the courts done this if the Contract does not allow Early Termination? They have done it by deciding that Managers have breached fiduciary and other obligations that Managers would probably say they didn't know they owed. Based on that alleged breach or other theories, courts have allowed

---

**Joshua Stein**, a real estate partner in the New York office of Latham & Watkins LLP and a member of the American College of Real Estate Lawyers, has written extensively on commercial real estate law and practice. ALI-ABA has published two of his four books. Copies of many of his articles appear at [www.real-estate-law.com](http://www.real-estate-law.com). The author acknowledges with thanks the editorial contributions of Robert Kao, University of Pennsylvania Law School Class of 2006; Michael D. Mosley, the author's editorial assistant; and Donald H. Oppenheim of Meyers Nave PC. Copyright © 2006 Joshua Stein ([joshua.stein@lw.com](mailto:joshua.stein@lw.com)).

---

If a Manager wants to mitigate the risk of Early Termination but never asks for any special protections, the Manager has no chance at all of ever obtaining any.

---

Owners to terminate regardless of the terms of the Contract.

In response, Managers have added new language to their standard Contracts, often in all capital letters. Some of that language might help. But the legal principles that apply are often rather intricate or technical. Hence, a Manager cannot be certain that even the “new and improved” Contract language will prevent Early Termination.

Going forward, any Manager or its counsel may want to consider this body of case law, and take it into account in negotiating and structuring tomorrow’s Contracts. And if an Owner wants to renegotiate anything in an existing Contract, a Manager may find it has enough leverage to add some measures to respond to this body of case law.

Managers will want to pay particular attention to these issues when they take over management of “trophy” assets or sell major hotels they own and want strong assurances they will be able to continue to manage the asset after the sale. (In some cases, they would not want to sell the asset unless they obtained those assurances.) Managers will care less about these issues for smaller, less visible, or more readily replaceable hotels.

For major transactions in which a Manager fears the risk of Early Termination, this article

presents some ideas for structural protections that a Manager might consider trying to obtain from an Owner, as mechanisms to prevent Early Termination. The measures suggested here seek to respond to the theories for Early Termination relied upon in reported cases in which the Owner won, and the underlying legal principles that support those theories.

This discussion amounts to “brainstorming”—with no assurance at all that any particular suggestion will work or make any sense at all in any particular case. Given the importance of this issue to a branded hotel Manager that wants to know it will control a major asset for a long time, though, this issue may merit some brainstorming.

The author does not “endorse” or “recommend” any particular option presented in this article. To the contrary, the author acknowledges that in many (perhaps most) cases, a Manager may not want to ask for anything out of the ordinary. Even when a Manager does make that request, an Owner may refuse to cooperate. In representing an Owner, the writer would argue that almost everything suggested here is “off market,” “non-standard,” or “over the top.” But some Owners may be willing to accommodate, particularly if they need the Manager badly enough. And if a Manager wants to mitigate the risk of Early Termination but never asks for any special protections, the Manager has no chance at all of ever obtaining any.

Some protections discussed here work best if a Manager starts out owning the hotel, and sells it to a new Owner, who then enters into a Contract with Manager. More typically, of course, Manager has no existing ownership interest in the hotel, so those particular protections would not apply, or would require some extra steps.

The suggestions offered here focus more on practicalities than legalities, because relatively

little law specifically governs the Owner-Manager relationship. To the limited extent such law exists, these proposals seek to respond to the principles (such as they are) and “bad facts” that have driven some of these bad results (“bad” at least from a Manager’s perspective).

The table after these introductory comments lists about 30 measures a Manager might consider proposing to mitigate the risk of Early Termination. Some are unconventional; others rather routine. These measures—particularly the unconventional ones—will often make no “business sense” or even be perceived as bizarre in a particular transaction. In other cases, one or more of them may make perfect sense for both parties. In any case, they may spark further discussion and inspiration and perhaps ultimately lead to some other protective measure(s) that both parties can accept. To the extent that Manager even raises these issues, however, Manager should expect significant “push back” from Owner and its counsel.

Possible protections are ranked in their likely order of effectiveness, as the author assesses it. In each case, Manager’s counsel would need to “tie” the Manager protection back to the Contract and the larger transaction, by demonstrating that the Contract and the Manager’s special protective measure amount to an integrated transaction that the courts should honor. Deciding exactly how to achieve that will fall upon Manager’s counsel.

Each measure suggested here is accompanied by some comments on how it might affect the execution of two crucially important transactions:

- A possible sale of the Hotel, if Manager already owns it and wants to establish Early Termination prevention measures in selling it to a new Owner; and

---

A Manager needs to obtain, for example, an “agency coupled with an interest” or some real property interest or some extra protection to make Early Termination difficult or impossible.

---

- Owner’s closing of industry-standard nonrecourse financing from a mortgage lender (a “Lender”).

Owners and Lenders may react to particular protective measures in different ways. The table in this article attempts to summarize those reactions, in an extremely abbreviated way. Any particular transaction will require more nuanced consideration of potential buyers, their tastes, the state of the market, and the tolerance of likely buyers for creative or unusual measures like these. Finally, the suggestions offered here do not constitute guaranties of any kind and consider no tax issues.

The following questions and general principles drive all Manager protection measures this article suggests:

- *How can a Manager deny an Owner a right of Early Termination?* In general, this requires giving the Manager something more than a mere “contract right”—a stream of income in exchange for management services (legally, a “contract for personal services”). Instead, a Manager needs to obtain, for example, an “agency coupled with an interest” or some real property interest or some extra protection to make Early Termination difficult or impossible. The first requires compliance with various technical requirements—so technical that any court

can probably always find some reason the Manager failed to comply. Hence a Manager might focus instead on obtaining some real property interest or other protection and “tying” it to the Contract;

- *How can a Manager reliably make Early Termination as expensive as possible for an Owner?* This requires persuading a judge that Early Termination imposes legally recognizable costs and losses on Manager. Ideally, Manager would like to achieve that result without extensive factual debate. The Contract can help Manager achieve these goals;
- *How can a Manager assure that it will actually collect whatever compensation a court might award for Early Termination?* This issue is not at all unique to Contracts, and arises in commercial contexts of all kinds.

By raising and perhaps resolving these issues—and special “Manager protection measures”—at the earliest possible stage in a transaction, a Manager might eliminate negotiations that could otherwise prove frustrating. As a common instinct, however, Managers may prefer to relegate Early Termination prevention devices to be resolved later—a tedious legal issue to be handled by the lawyers—and not treat this issue as part of the basic deal negotiations.

That approach assures that once the parties actually wrestle with the problem, Owner’s counsel will spend a great deal of time and effort in identifying risks, analyzing interesting legal issues, trying to trim Manager’s protections, and otherwise complicating matters. A Manager can streamline that process by treating Early Termination prevention as part of the initial “business deal,” so it is “baked into” the parties’ understanding (the first term sheet for the transaction) and not subject to renegotiation. That approach will make even more sense if Manager intends to adopt extreme or unusual

measures (some of which are suggested here) to mitigate the risk of Early Termination.

In the case where a Manager already owns the hotel, plans to sell it, and intends to continue managing it after a sale, a Manager should consider adopting a market-based and transparent approach to this problem. In its “request for proposals” or other document soliciting bids, a Manager may want to tell potential bidders about its concerns on Early Termination. The RFP might offer bidders a laundry list of “Manager protections” along the lines suggested here, and invite each bidder to propose its own tailored package to address Manager’s concerns.

By raising this issue at the RFP stage, Manager could:

- Consider these issues in evaluating bids for the hotel including any reduction in selling price these measures might produce;
- Let bidders tailor their “protection package” to their own particular tastes, hence perhaps producing more attractive bids;
- Incentivize bidders to accommodate Manager; and
- Reduce the likelihood of “retrading” these issues in negotiating definitive documents.

This approach would probably be quite effective, and would not tell bidders anything they do not already know. It could also reduce the risk of Early Termination by giving Manager at least some appropriate handful of the protective measures that follow.

On the other hand, Manager’s request for Early Termination protection might prompt gales of laughter from Owner and its counsel. In that case, if Manager drops the request, this may create bad “legislative history” if the transaction ever goes into litigation. Manager will then want to focus with special care on assuring that a court will not admit the “legislative history” into evidence.

## Possible Measures To Prevent Early Termination Of Hotel Manager

*Reminders: Some of these measures assume Manager already owns the Hotel and contemplates selling it to a new Owner, while retaining a Contract. In the more typical case where Manager has no existing interest in the Hotel, some of these measures won't work or will require adjustment. In all cases, feasibility of any of these measures will depend on market conditions. Manager will typically face an uphill battle.*

| Possible Measure  | Effectiveness to Prevent Early Termination   | Transaction Impact   |
|---|--|--|
| <p>1. Convert management agreement to a lease, demising possession of real estate in exchange for rent, not merely creating a contract right. Calculate rent to approximate Owner's cash flow under "management agreement."</p>                       | <p>Highly effective, granting possession rather than mere contract rights. Even in bankruptcy, Owner cannot shake off a lease. Owner could "reject" but Manager could stay in possession, so rejection becomes almost meaningless. This assumes Manager acts promptly to protect itself, unlike the tenant in the widely reported <i>Qualitech</i> case.</p> | <p>The marketplace has moved away from "leases" to "management agreements." A "lease" would be regarded as a major variation from "market." It could chill an Owner. Lenders would probably worry less.</p>  |
| <p>2. In addition to management agreement, give Manager a long-term below-market lease of entire facility.</p>  | <p>Also highly effective as backup in the event of Early Termination, assuming not treated as disguised security arrangement.</p>  | <p>Same as above. An Owner might also regard this measure as overly "cute."</p>  |
| <p>3. Remain owner of the hotel. Don't sell it. Instead, lease it to "owner" for 40 years, with purchase option at end. Require in the lease that Manager remain manager. Failure to comply would trigger major rent adjustment or lease default.</p> | <p>This fits neatly into real estate categories and established deal structures, and should be quite effective, including in bankruptcy.</p>   | <p>A buyer who wants to buy probably won't want to lease. A lease may cause a cash deferral that disserves Manager, though "rent" can perhaps be front-ended. Lender's concerns about "financeability" of lease can readily be handled through typical Lender protections.</p> |

| <b>Possible Measure</b>   | <b>Effectiveness to Prevent Early Termination</b>   | <b>Transaction Impact</b>   |
|---|---|---|
| 4. Manager keeps roadways, parking areas, or other components of the hotel, and grants only an easement, which Manager could terminate on Early Termination.  | Highly effective, though bizarre. Would require compliance with technical law of servitudes, but this is achievable.  | Probably a non-starter, simply because so unusual. Some Owners may tolerate, however. A Lender will treat terminable easement as being much like a lease, and demand Lender protections.          |
| 5. Owner could deed or lease to Manager a small revenue-producing part of the project, and tie any protections to Manager's ownership interest in that parcel.  | Should help establish an interest beyond that of a mere fee-based manager.  | Impairs Owner's goal of 100 percent ownership. Could mitigate via buyout option on terms favorable to Manager. Lender would ask whether Manager's role would impair value or deter future buyers. |
| 6. Record a restriction against the hotel, requiring operation only under a brand name that Manager controls, or otherwise imposing obligations and restrictions that assure Owner will keep Manager. | Varies depending on enforceability of the restriction under state law (does it "run with the land?" does it "touch and concern?"), and possible impact of bankruptcy law. | Recorded restrictions are common, though Owner may regard this one as "weird." Lender can factor into its underwriting.   |
| 7. Refer to the above recorded restriction in Owner's deed, to try to define Owner's estate to exclude whatever Manager "holds back" through the recorded restriction.                                | Mostly depends on enforceability of recorded restriction.   | Deeds often refer to previous recorded instruments. This reference (in and of itself) would not be perceived as bizarre.  |

| <b>Possible Measure</b>   | <b>Effectiveness to Prevent Early Termination</b>   | <b>Transaction Impact</b>   |
|---|---|---|
| 8. The same entity acting as Manager could maintain some material ownership interest (e.g., five percent ownership or economic interest in the facility or in Owner). | Cases on “agency coupled with an interest” emphasize agent’s holding a present property interest in the asset, for benefit of agent, other than the stream of payments for services. Partial ownership should suffice, assuming held by the exact same entity as agent.                 | Owner would probably want 100 percent ownership. In a sale context, a retained interest could chill bidding. Lender would insist that a foreclosure terminate Manager’s interest, partly defeating purpose. |
| 9. Require Owner to pay substantial “liquidated damages” (or formulaic “termination fee”) on Early Termination.   | Courts do award damages to Managers that were prematurely and/or wrongfully terminated. Liquidated damages should fill that bill. Manager would need to make liquidated damages “enforceable,” not too hard to do. Unsecured damages offer little value in an Owner bankruptcy, though. | Owner should have high tolerance for liquidated damages as long as the issue arises in the competitive bidding stage for a sale of the hotel to Owner. Lender may demand limits on Manager’s enforcement.   |
| 10. Require Owner to deliver mortgage to secure damages payable upon Early Termination.   | Assuming a measure of damages high enough to deter Early Termination, a mortgage should be highly effective, including in bankruptcy (though subject to “cram down” risk).  | Owner would probably object on general principles. Lender would object to mortgage, whether “senior” or “junior.” Could mitigate through intercreditor arrangements.  |
| 11. Require Owner’s equity holders to pledge their interests to secure damages on Early Termination.  | Similar to a mortgage on the real estate, though somewhat diluted.  | Would impair Owner’s ability to obtain mezzanine financing. Would also need to be “sold” to Lender.   |

| <b>Possible Measure</b>   | <b>Effectiveness to Prevent Early Termination</b>   | <b>Transaction Impact</b>  |
|---|---|--|
| 12. Manager provides long-term loan to Owner, non-pre-payable, to show Manager has an interest beyond that of receiving management fees.                        | As long as the loan amount is significant (more than two- or three percent of the property value), it does offer strong support to show Manager is more than a mere agent/manager.                | Owner may like the extra financing. If not secured, should be quite easy to document and negotiate. If secured, could set up as a "mezzanine loan," a common real estate loan structure. Lender may demands limits on enforcement. |
| 13. Manager commits to provide such a loan to Owner, in certain circumstances.  | Similar effect, though somewhat diluted.  | Same as above.   |
| 14. Make Manager a "special member" of Owner, with rights limited to: (a) approving an Early Termination; and perhaps (b) fees consistent with management deal. | LLCs are very flexible. Such a structure would probably work and be enforced. Totally untested, though. No apparent risks (e.g., exposure to Owner's creditors).                                  | "Special" members show up all the time in LLCs (hence will not surprise Owner or Lender), though not this type of special member. Owner may object to Manager's quasi-ownership interest.  |
| 15. Other actions to make Manager entity (same entity as "agent") a partner or joint venturer of Owner.   | Should strongly support an agency "coupled with an interest." Use shell subsidiary to mitigate creditor risks.  | Owner will want 100 percent ownership. Lender would insist that a foreclosure terminate Manager's interest, partly defeating purpose.  |
| 16. Give Owner only a license for the Manager's brand name, which would automatically terminate on Early Termination.   | Depends on availability of other brand names or market tolerance for "new" brand name. (Desire to protect intellectual property rights or brand value would not alone prevent Early Termination.) | No Owner will expect a "free ride" on the brand name. Hence risk of losing the brand name should not chill a transaction for Owner or Lender.  |



| Possible Measure   | Effectiveness to Prevent Early Termination  | Transaction Impact   |
|--|---|--|
| 17. Allow Manager to (re)purchase hotel on any Early Termination. Record the option right.   | Probably very effective, at least outside Owner bankruptcy. Issues of “enforceability” if deemed a penalty (e.g., unreasonably low pricing). Hence, may want to provide for “fair market” pricing, with an extended closing to arrange financing. | An Owner, and particularly its Lender, might object to this arrangement as a “forfeiture.” (But see pricing comments to the left.) To mitigate Lender concern, provide extensive cure rights and other Lender protections. |
| 18. Obtain guaranty from Owner’s creditworthy parent company, with financial covenants and reporting. Guaranty covers only Owner’s obligations upon Early Termination. | Assuming strong credit, both present and future, should create strong incentives against Early Termination.   | Limited guaranties are common in real estate finance, hence familiar to the market. Lender would probably not care, though Owner would say otherwise.  |
| 19. Use the words “agency coupled with an interest,” but agent and interest holder must be identical, and interest must be direct and go beyond mere fee income.       | Mere recital will not suffice to create an agency coupled with an interest. The requirements for “coupled with an interest” are technical. Judges always seem to be able to find some reason they are not satisfied.                              | “Plain vanilla” and predictable from any manager. Owner and Lender will probably not raise an eyebrow.   |
| 20. Recite that Manager’s fees amount to an “interest in the business” received in exchange for giving up something of value—not a mere stream of cash.                | Some cases place weight on concepts like these. They are hardly foolproof if a court decides Owner is the “good guy” and Manager the “bad guy” under particular facts.  | Should do no harm to executing a transaction.  |

| <b>Possible Measure</b>   | <b>Effectiveness to Prevent Early Termination</b>  | <b>Transaction Impact</b>  |
|---|--|--|
| 21. Because Early Termination often is premised on “breach of fiduciary duties,” try to limit and waive (or at least define) any such duties. <sup>1</sup>  | Unlikely to eliminate all fiduciary duties, so the risk remains. Court may find a waiver or partial waiver of fiduciary duties to be distasteful, and “punish” Manager for trying. | Likely to create ill will and difficult negotiations with Owner. Lender probably won’t care.   |
| 22. Structure management agreement to make it extremely difficult for Owner to declare Manager in “breach,” <sup>2</sup> because a Manager “breach” can excuse Owner from damages for Early Termination.      | Does not prevent Early Termination, but helps preserve damages claim, hence significantly deterring Owner from trying to terminate.  | If Owner recognizes that Manager is serious about long-term management, Owner should live with provisions of this type, common in other long-term relationships. Lender may approach the same way. |
| 23. Expressly allow Manager to obtain injunction against termination, with explanation of “irreparable damage” and other elements of equity jurisdiction. Waive bond requirement if Manager seeks injunction. | Not highly effective. If the law allows an Early Termination, a court would probably not enjoin it.  | Owner and Lender would probably not object to such provisions.   |

<sup>1</sup> For example: (a) expressly negate any fiduciary duties; and/or (b) state that Manager’s fiduciary duties shall be limited to those expressly stated in the Contract.

<sup>2</sup> For example: (a) define Manager’s duties as specifically as possible; (b) negate any implied or common law duties; (c) provide extensive notices and cure periods (including open-ended cure periods for any default not readily curable); (d) expressly negate termination as a remedy for most defaults; and (e) establish contractual remedies and dispute resolution procedures.

| Possible Measure   | Effectiveness to Prevent Early Termination  | Transaction Impact   |
|--|---|--|
| 24. Add further protective language to management agreement based on language in recent management agreements. <sup>3</sup>  | Creative new language has not yet been tested in the courts. It may work. Even if it doesn't, it should do no harm, unless a court uses it as evidence of Manager's evil approach to the entire relationship.                               | Additional negotiations. If buyer ultimately waters down the language, this "legislative history" could look bad in future litigation. Lenders probably will not care. |
| 25. Require Owner's organizational documents to limit Owner's business activities to preclude Early Termination. Prohibit amendment of that section without Manager's consent. | Restrictions of this type are common in real estate financing but relatively untested. Should do no harm, though. If Owner sells hotel to a new owner, or ignores the restriction, what remedy does Manager have? Consider a guaranty.      | Owner should not object to this requirement (except probably a guaranty). It should also appear quite familiar to any Lender.  |
| 26. Define Manager's role as "independent contractor" not "agent" to try to avoid cases that allow free termination of an "agent."   | "Independent contractor" raises its own issues and would not help in bankruptcy. Manager would remain an unsecured creditor.  | Owner may prefer "independent contractor," as it may reduce Manager's authority and Owner's exposure. Lenders won't care.  |
| 27. Require Owner to meet rating agency "single purpose entity" requirements.  | Mitigates but does not eliminate bankruptcy risk, making other measures more attractive. Relatively worthless without "warm body" guaranty of SPE compliance. Also, by definition SPE implies zero credit. Hence a guaranty may make sense. | Lender will probably require SPE structure anyway. This format is exceedingly common in real estate and should not cause legitimate concern by either Owner or Lender. |

<sup>3</sup> For example: (a) Owner waives any right to terminate except under express terms of Agreement; (b) Owner acknowledges Manager holds an "agency coupled with an interest" and termination would cause Manager grave and irreparable loss; (c) recitals of grievous damage Manager would suffer to its brand and reputation on early termination; (d) Owner's express consent to use of Affiliates with vague standards of "competitive" pricing; (e) Owner acknowledges no assurances regarding financial results or profitability; and (f) Owner waives any implied or common law obligations.