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The rise of hospitality disputes

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Summary

IN SUMMARY

The hospitality industry experiences a constant tension between hotel owners' search for a high rate of return and operators' concerns about maintaining their brand standards and style. The covid-19 pandemic has exacerbated this economic tension and triggered disputes between owners and operators. This is likely to continue in the months and years to come, with tensions arising from real or contrived disputes citing material breach or default on the part of the other party.

DISCUSSION POINTS

- The relationship between hotel owners and operators
- Branding and how it affects the dynamic between hotel owners and operators
- Dispute resolution through mediation or arbitration

REFERENCED IN THIS ARTICLE

- Cases tried in the Singapore courts
- Singapore International Arbitration Centre

RELATIONSHIP BETWEEN OWNERS AND OPERATORS

In considering the owner–operator relationship, two key aspects are important:

- the level of control conferred on an operator by the hotel owner; and
- the express obligations of the operator, who is usually an independent contractor providing an agreed set of services contracted for, not an agent who would owe certain fiduciary or implied obligations to the owner.

The hotel owner places great financial reliance and confidence on an operator to achieve optimal management and operation of the hotel in a manner that is mutually beneficial to both parties. Further to this reliance and confidence, the hotel owner confers a great amount of control to an operator. The hotel owner, who would have made substantial financial investments into acquisition and development of the property, would like to see immediate returns on its investment and relies heavily on the experience and brand name of the operator it has hand-picked. The financial commitment by the hotel owner carries on for the term of the operation agreement, which can typically last for more than 10 years with an option to renew, usually at the option of the operator. All costs associated with the real estate and the maintenance of the property lie with the hotel owner. Operators typically take one component of their management fees off the top, meaning that operators will be paid their management fees regardless of whether the owner has realised any profit for that material period.

The operator, especially one with an established brand name and a multitude of hotels under its management, needs to ensure consistency in the service, marketing, branding and promotion of all the properties it manages, since the market's perception of the operator's brand is formed by the image of and interactions with properties associated with the brand.

This is what attracts clientele to the hotels managed by these operators and what keeps such clientele returning to these hotels. This, in turn, leads to the return on investment that each hotel owner counts on for each endeavour and the operator gaining more owners for its portfolio.

The level of control that an owner confers on an operator is obviously directly proportionate to the owner's expectations that the operator is responsible for and will meet the financial performance metrics. It is when these expectations are not met that disputes typically originate from the owner's side.

An operator, who typically manages multiple hotels, requires a great degree of control to ensure consistency across multiple properties that are similarly branded, to maintain the service quality level commensurate to that brand or to ensure a consistent experience for properties that are branded the same. When the owner is not prepared to fund the maintenance and periodic refurbishment and refreshing of the property, disputes typically originate from the operator's side.

Notwithstanding express contractual terms, the issue of control becomes a friction point. On one hand, the owner wishes to safeguard its investment and ensure the best possible return on it by being able to make decisions that are, in the owner's view, in the best interests of the hotel. These decisions typically focus on cash flow generation by increasing occupancy and cutting costs. The operator is, of course, more concerned with maintaining its brand image and looks at the impact across its brand, not just in terms of the economics of that particular property, and is usually reluctant to cede too high a degree of control to the owner.

With hotel owners being most concerned about the bottom line, any adverse impact on the financial performance of the hotel in which they have invested heavily invariably leads to allegations of material breach by the operators in the mismanagement of the hotel. Such allegations often lead to hotel owners terminating the hotel management agreement. That said, due to the relationship of being an independent contractor and not an agent, the hotel owner (in principle) is unable to terminate without cause. The owner would have to rely on an express term of the hotel operation agreement to open the way for termination.

Such a termination will be met with the operator's strenuous objection to allegations of mismanagement, and the operator will defend its performance and brand name. A close examination of termination disputes shows that the underlying issue is usually the misalignment of perceptions and expectations of the economics of operations. While, in many cases, commercial negotiations can and do resolve these, parties should consider clearly setting out minimum expectations, no-fault termination and payment adjustment clauses.

KEY DISPUTES

Various cases concerning hospitality disputes have come before the Singapore courts, mostly at the enforcement stage, as most hospitality disputes are resolved through arbitration. Owners and operators have usually agreed on arbitration to benefit from confidentiality, which is important to owners who do not want market disruption to their bookings and guests, and to operators who do not want their commercial issues aired in public.

Reviewing these cases, we see that such disputes arise throughout the various stages of the owner–operator relationship, from the financing stage to the development stage to

commission and operation. Disputes also cover the intellectual property and data security space, with hotels not spared from certain ransomware attacks in 2020. These attacks had grave implications in relation to the privacy and data protection of guests from all parts of the world.

The examples cited below show the typical range of disputes in which hotel owners and operators get involved.

Misrepresentation And Material Breach Of The Management Services Agreement

Bloomberry Resorts and Hotels Inc and another v Global Gaming Philippines LLC and another[1] was a case where the plaintiff (hotel owner) sought to terminate the management services agreement (MSA) on claims of alleged misrepresentation inducing it to enter the MSA, and also alleged a material breach of the MSA by the defendant. The claimant commenced arbitration, seeking declarations that it had been induced into entering the MSA and that it had rightfully terminated the MSA. The claim was dismissed by the tribunal.

Whether Sale Of Hotel Breached Warranty Given By Owner

Park Regis Hospitality Management Sdn Bhd v British Malayan Trustees Ltd and others[2] concerned a claim by the hotel operator against the owner for breach of the hotel operating agreement by the owner's sale of the hotel to a third party. While the operating agreement did contain express warranties that the owner was the owner of the property, these were held to be warranties as to the state of affairs on the date of the agreement and did not amount to a warranty or promise that the owner would remain as such throughout the term of the operating agreement.

Claim Under Law Of Passing Off

While this is not a hospitality dispute between the parties to a management agreement, it shows the importance of branding and trademark in this space. In ***Novelty Pte Ltd v Amanresorts Ltd and another***,[3] the claim was brought by Amanresorts against Novelty. The respondents in the appeal were companies operating under the Amanresorts Group, which operated ultra-luxury resorts in many locations around the world. Amanusa, which opened in Bali in 1992, was one such resort. The respondents were also in the residential accommodation business and they licensed the prefix 'Aman' to various real estate projects in return for a fee. The respondents also had luxury goods and services with the Aman name. While the word 'Aman' was never registered as a trademark in Singapore, the name 'Amanusa' has been a registered trademark since 1998. The appellant developed housing projects in Singapore and was known for reasonably priced developments in convenient locations. In 2005, the appellant named a Balinese-themed housing project in Singapore 'Amanusa'. The respondents took legal action against the appellant under the law of passing off, and also under section 55(3)(a) of the Trade Marks Act.[4] The High Court found that the 'Aman' names were well-known trademarks in Singapore and that both claims were made out. The appellant appealed against the High Court's decision but the appeal was dismissed by the Court of Appeal.

Conclusions

These hospitality disputes arose before the covid-19 pandemic. A common factor in the first two cases referred to above is the desire to terminate the relationship by one of the parties. The covid-19 pandemic has seen and will continue to see all players in the hotel

industry space being affected in terms of the generation of revenue, the control of costs and, ultimately, the ability to service financing obligations.

New hotel projects or refurbishments to existing hotels have been delayed due to shortages in the supply of materials or workers. Rooms have been vacant due to travel bans and lockdowns and employees have been left in limbo. Hotel operators are finding it increasingly difficult to meet financial performance metrics set out in hotel management agreements. As regards hotel owners, they will be unable to meet capital requirements set out in these agreements to meet operating standards. The party that is in breach is likely to look for a reason to terminate the relationship. Looming over all this is the debt-servicing obligation incurred for the acquisition of the property and the danger of foreclosure by the owner's lender.

The cases above show that, in addition to the dynamic relationship between hotels owners and operators, another key area where disputes are likely to rise (as seen in ***Novelty Pte Ltd v Amanresorts Ltd and another***) is the area of intellectual property and branding.

INTELLECTUAL PROPERTY AND BRANDING

A hotel operator's branding and track record reflects the product it offers and creates the expectation of performance and financial success in the mind of the owner. Guests rely on the branding for the expectation of the experience when they stay at the hotel. In all situations, individuals want a good experience when they stay at a hotel. In certain instances, name recognition by clientele is enough to draw in business for the hotel whose brand name has come to be associated with a particular type of experience or exceptional service. Tied to this concept of a brand is that of a trademark (a visual representation of the brand), which identifies and distinguishes the brand of the hotel operator from its competitors.

The use or even creation of a brand or trademark for a hotel is sometimes a collaboration between the owner and the operator. It is built upon the hotel owner's desire for its hotel to have certain distinctive characteristics, often taking into consideration the country or specific location of the hotel and melding this with the existing brand of the operator to create something distinctive that promises all the qualities, characteristics and traits already associated with that brand. The collaboration on the creation of such a brand requires both parties to develop, grow and build the brand. However, a falling out would lead to a potential minefield if the operating agreement and the associated branding and marketing agreements have not expressly dealt with the various scenarios that may arise. The manner in which intellectual property rights were dealt with in the agreements and in the performance of the agreements will have a significant impact on how the relationship will be unwound.

MANAGING THE DISPUTE

Hotel management agreements usually have dispute resolution clauses that call for any dispute between the hotel owner and the operator to be resolved through arbitration. This is done to keep the dispute confidential due to the impact such a dispute may have on potential lenders and investors, and the reputations of both the owner and the operator.

Any termination of the hotel management agreement will find the parties caught up in arbitral proceedings for a significant period. Even though parties usually resort to arbitration, which is confidential in nature, word of such disputes invariably gets out to the public; this does no good to the reputation of the owner or the operator. Further, time spent embroiled in arbitration would be better served by each party engaging fully in their own commercial

interests. The start of a dispute often results in significant disruption to the operations of the property as the battalions of lawyers from each side focus on perceived strict legal rights and jockey for what parties think is the legal high ground.

Other than having a tightly worded management agreement, it pays to consider provisions to manage a dispute and ensure that those provisions expressly provide for interim measures that apply whenever a dispute arises, which do not require assessment of fault. This should be coupled with provisions such as a requirement for amicable negotiation and mediation to be conditions precedent before arbitration is engaged.

Prevention is better than cure. One needs to pay close attention at the start of the relationship between hotel owner and operator to the commercial expectations of the parties, and these should be clearly reflected in the contractual terms of the management agreement.

Parties should be specific about the obligations owed by each party, and set up clear lines of communication and clear procedures and processes to be employed to resolve disputes. During the course of the operation of the hotel, each side should keep a watchful eye on the terms of the management agreement that has been executed and be meticulous about the retention of correspondence and documentation showing performance or lack of performance in accordance with the terms of the management agreement.

Increasingly, hotel operation agreements contain liquidated damages clauses in areas such as loss of profit for wrongful early termination. Such clauses avoid the hard-fought battles relating to assessment of loss and that require arbitrators who are familiar with the hospitality industry. Experts will usually have to be called upon by both sides, which will necessarily increase the cost of the arbitration. Having such a clause may narrow the dispute on the amount of loss and damage being sought and ensure more certainty. Liquidated damages clauses will usually be based on the operator's anticipated profits for the remainder of the operation term calculated from the date of the alleged termination.

Another clause that is being seen more often in hotel operating agreements is a clause setting out the parties' agreement that neither has a right to terminate the agreement where there is a bona fide dispute between them and the dispute has been submitted to arbitration. This effectively keeps the status quo between the parties while the actual dispute is being arbitrated. Such a clause has the added effect of getting parties to work out their differences, possibly through mediation or resolution through an expert, as provided for in the hotel operation agreement. This may be the best course of action as it is in the interest of the owner to quickly replace the current operator with another hand-picked operator and lets the operator seek a resolution such that its brand is not adversely affected.

MEDIATION AND APPOINTMENT OF AN EXPERT DURING THE TERM OF THE HOTEL OPERATION AGREEMENT

It will serve parties well to have some form of mediation process that either side can call upon at the onset of a dispute. The recourse to mediation can take place as a precursor to arbitration and at least gives parties some procedure to try to resolve their disputes amicably.

The mediation process allows the disputing parties to call upon a mediator (pre-agreed) who has the expertise in the hospitality industry and can appreciate the complexity of various factors to a hospitality dispute. Such an expert can balance the competing interests of the owner and the operator. The parties also have more control over the outcome in a mediated settlement, which would allow parties to reset their relationship.

An alternative or additional mediation route is for parties to consider appointing an independent expert from an internationally recognised consulting firm or an individual qualified to resolve the issue in question. This appointment can be by agreement of the parties or, failing that, by each party selecting one expert and the two selected experts then choosing a presiding expert to resolve the particular matter in dispute. Specific aspects of the operation of the hotel on which parties disagree can be referred to this expert. An example of an area where an expert could be usefully called upon would be alleged operational breaches relating to budget and performance.

In the past, it could be difficult to enforce a mediated settlement. This was addressed in the Singapore Convention on Mediation, which gives businesses around the world greater certainty on the enforcement of mediated outcomes. The Singapore Ministry of Law announced the following in a press release dated 12 September 2020:

> As of 1 September 2020, the Convention has 53 signatories, including the United States, China and India. . . . With the Convention in force, businesses seeking enforcement of a mediated settlement agreement across borders can do so by applying directly to the courts of countries that have signed and ratified the treaty, instead of having to enforce the settlement agreement as a contract in accordance with each country's domestic process. The harmonised and simplified enforcement framework under the Convention translates to savings in time and legal costs, which is especially important for businesses in times of uncertainty, such as during the current COVID-19 pandemic. With the Convention, businesses can rely on mediation as a dispute resolution option for their cross-border transactions, with greater certainty and assurance that their mediated outcomes are enforceable. The conciliatory nature of mediation also helps to preserve commercial relationships despite the disputes.

ARBITRATION

If, having exhausted all amicable forms of resolving the dispute, arbitration is resorted to, there are various procedures that can be employed under the applicable arbitration rules, such as certain expedited procedures, bifurcation of the hearing and employing interim reliefs to preserve the positions of parties pending arbitration.

One benefit of the covid-19 pandemic has been the use of virtual hearings, which eliminate travel time to the arbitration venue and reduce the costs of the arbitration.

As an example, the Arbitration Rules of the Singapore International Arbitration Centre 2016 provide specifically for an expedited procedure. These allow for the following, where agreed to between the parties:[5]

- for the timelines under the Arbitration Rules to be abbreviated;
- for a case to be referred to a single arbitrator unless decided otherwise, mainly in more complex cases;
- in consultation with the parties, the dispute may be decided on the basis of documentary evidence only;
- a time frame of six months is set within which the final award is to be made; and
- for the tribunal to state the reasons on which the final award is based in summary form.

In addition, parties can also seek recourse under Rule 29 for an early dismissal of claims and defences.[6] A party can avail itself of recourse to emergency or interim relief in a court of law without waiving its right to proceed with arbitration in the event that an arbitration tribunal has not been convened or the tribunal does not have time to consider the application. In any event, emergency interim relief can also be sought by parties to an arbitration 'concurrent with or following the filing of a Notice of Arbitration, but prior to the constitution of the Tribunal'.[7]

There are similar provisions in the Hong Kong International Arbitration Centre's Administered Arbitration Rules 2018, the China International Economic and Trade Arbitration Commission's Arbitration Rules, the International Chamber of Commerce's Arbitration Rules and the Japan Commercial Arbitration Association's Commercial Arbitration Rules 2021.

CONCLUSION

Although the essence of a hospitality dispute is contractual in nature, there are various overlapping areas of which one needs to have knowledge and understanding; for example, in the areas of intellectual property, agency and good faith, building construction, consultancy, and data protection.

Carefully considered and detailed express terms structuring the hotel owner and operator relationship as set out in a hotel operation agreement, with an eye on potential areas of conflict and management of the same, are imperative, with recourse to arbitration providing the most protection in terms of ensuring confidentiality of the facts and the dispute, and also in terms of enforcement.

* *The content of this article was accurate as at May 2022.*

Endnotes

1 [2021] 3 SLR 725A. ^ Back to section

2 [2014] 1 SLR 1175. ^ Back to section

3 [2009] SGCA 13. ^ Back to section

4 Chapter 332, 2005 Rev Ed. ^ Back to section

5 Rule 5 of the Arbitration Rules of the Singapore International Arbitration Centre 2016 (the SIAC Rules 2016). ^ Back to section

6 Rule 29 of the SIAC Rules 2016. ^ Back to section

7 Schedule 1 to the SIAC Rules 2016. ^ Back to section

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