

# Hotels Resorts & Tourism

## Newsletter

Global

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### The Ritz-Carlton Case – Why it may not matter that much

P.T. Karang Mas Sejahtera v Marriott & Ritz-Carlton –  
US District Court, Maryland District, Southern Division



Ritz-Carlton Bali Resort  
Bali, Indonesia

*(Image courtesy of The Ritz-Carlton  
Company website)*

The recent award of \$10 million in punitive damages in proceedings P.T. Karang Mas Sejahtera (KMS) and Marriott International Inc. and The Ritz-Carlton Company LLC (Ritz-Carlton) has provoked considerable discussion on the effect of that decision for the hotels industry. The purpose of this article is to examine the decision in its proper context, and to look at what general application it has (if any) on owners and operators in similar situations.

#### Background

A brief summary of the background facts to this case is set out below.

- 1991 KMS and Marriott enter into operating agreement for the exclusive operation of the KMS-owned Ritz-Carlton Bali Resort (the Resort). The operating agreement contained a clause precluding the operation of another Ritz-Carlton on Bali (as discussed in more detail below).
- 1995 Marriott acquires controlling interest in Ritz-Carlton Hotel Company.
- 1996 The Resort opens for business, operated by Ritz Carlton.
- 2002 Marriott subsidiaries and Italian jeweler Bvlgari S.p.A. enter into joint venture agreements for the Bvlgari Bali Hotel.
- 2006 Bvlgari Bali Hotel opens for business approximately 5 kilometers from the Resort, and is operated by Ritz-Carlton.
- 2007/8 KMS sues Ritz-Carlton for damages for breach of the operating agreement for the Resort and, in particular, for breach of the restraint clause and breach of fiduciary duty. The case is heard and decided by a jury in the United States District Court of Maryland.

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[Bvlgari Bali Hotel, Bali, Indonesia](#)  
(Image courtesy of the [Kiwi Collection Inc. website](#))

## Putting the jury verdict in perspective

The Ritz-Carlton case, while interesting of itself, does not create any binding precedent for future cases in common law countries, nor is it of any persuasive effect. Jury verdicts are necessarily confined by the facts of the particular case and they do not establish principles of law<sup>1</sup>, largely because there is no reasoned decision-making by a judge that can be upheld in future cases by the judicial process.

You can view a copy of the jury verdict by [clicking here](#). As you can see, the jury was asked to decide a number of questions by filling in a special verdict form with "yes" or "no" answers. There is no reasoning or elaboration of the verdict by the jury or by the presiding Judge.

Notwithstanding this, the case does contain some elements of general interest in relation to non-compete clauses and the application of fiduciary principles to operating agreements, which we will now discuss.

## Breaching the territorial restriction

The jury made its decision having been provided with instructions which had been prepared by the parties jointly. In those instructions the jury was asked to consider whether Ritz-Carlton had breached clause 2.7 of the operating agreement, which provided:

### *"2.7 Territorial Restriction*

*(a) From and after the [...] Commencement Date while this agreement shall be in effect, Operator shall not, without the prior approval of Owner [...] open or operate another hotel using the Ritz-Carlton Rights within the Island of Bali, Indonesia [...]."*

The operating agreement defined the "Ritz-Carlton Rights" as follows:

*"(i) the names and marks 'Ritz-Carlton'; (ii) the Ritz-Carlton logo attached hereto as Exhibit B; and (iii) all other words, trademarks, indicia of origin, slogans and designs (including restaurant names, lounge names, or other outlet names) used or registered by Ritz-Carlton or any of its Affiliates and which are used to identify or are otherwise used in connection with Ritz-Carlton Chain hotels [...] – all of the following being indicative of the renowned Ritz-Carlton mystique, programs, processes, procedures, and systems (including the philosophy that drives customer satisfaction, the business management model, business strategies, the employee selection, training and career development approach, and the Ritz-Carlton Standards)."*

The jury was instructed by both parties to only consider whether or not Ritz-Carlton had as a matter of fact used any of the Ritz-Carlton Rights other than "the renowned Ritz-Carlton mystique, programs, processes, procedures, and systems" in the operation of the Bvlgari Bali Hotel.

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<sup>1</sup> *Joslyn v Berryman* (2003) 214 CLR 552 at 602 [158], per Hayne J.

The jury were also asked to consider whether a breach of the non-compete clause, if they found that there was one, had or could have had a material adverse effect on the operation of the Resort, or on the respective rights of the parties under the operating agreement. The jury answered both questions in the affirmative.

The approach to non-compete clauses will of course vary from jurisdiction to jurisdiction. However, in many common law countries these clauses are construed narrowly; for example, in our view it would be unlikely that the facts of this case would lead to a finding of breach in a civil proceeding in Australia.

### **Ritz-Carlton as agent – fiduciary duties**

The jury was also instructed to consider whether Ritz-Carlton was in any way an agent of KMS, and if so, whether Ritz-Carlton violated any of the fiduciary duties that it owed to KMS.

The jury instructions set out the general principles of agency law applicable to the operating agreement (the law of the State of Georgia, U.S.A.). We will not attempt to summarize those here. However, the contract provided specifically that the parties' relationship was not one of agency but rather of an independent contractor. KMS nevertheless submitted that the agency relationship was not solely determined by contract, but could also be inferred through a course of dealing between the parties and the overall circumstances.

KMS sought to establish a relationship of agency between the parties so that it could argue Ritz-Carlton owed it fiduciary duties of loyalty and non-competition. This issue was considered at a pre-trial hearing. The presiding judge noted that "it's pretty clear that Georgia has a – states a very limited view of no compete clauses, so consistent with that, I'm not going to permit some argument in general that there's a duty of loyalty under agency that goes beyond what the contract says as far as what can or can't be done by Ritz-Carlton [...]". This would seem to have disposed of the argument put by KMS but despite the pre-trial hearing, the jury decided that there **was** a relationship of agency between the parties, and that as a result of this relationship, Ritz-Carlton owed KMS fiduciary duties. The jury also determined that Ritz-Carlton had violated those fiduciary duties. Unfortunately because of the legal forum there is no legal reasoning to explain the basis of the finding in these circumstances.

Again, from a common law perspective, the provisions of a contract between commercial parties at arms length are the primary source of parties' obligations and rights. While a fiduciary relationship can exist between contracting parties (an agency agreement being a clear example of this) as a general rule where a contract states that the parties are independent and one party is not an agent or fiduciary of the other, that will be upheld by the Court and fiduciary duties will not be imposed.

If you would like more information on any of the topics discussed in this article, please contact:



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## Take-outs

The jury awarded KMS \$382,304 in compensatory damages for breach by Ritz-Carlton of the provisions of the operating agreement discussed above and breach of fiduciary duty. This was in addition to the \$10 million awarded for punitive damages.

The jury also decided that Ritz-Carlton's breach of the operating agreement had or could have a material adverse effect on the operation of the Resort, and therefore determined that KMS was entitled to terminate the operating agreement on its terms.

As can be seen from the above discussion, a jury verdict such as this does not establish any precedent for future cases with similar facts in common law jurisdictions. It would also be highly unusual for a civil law court to give considerable weight to a jury verdict such as this. It does, however, provide the opportunity to consider ways in which a verdict such as this could be avoided in the future. Some thoughts to leave you with:

- consider including in the dispute resolution mechanism in your operating agreement a requirement that there be a mandatory escalation of disputes, and attempts to resolve them, to senior executives within the relevant organizations who are not directly involved in the day to day operation of the hotel and do not have an emotional attachment to the outcome of the dispute;
- consider your alternative dispute resolution clause as something more than just a "boilerplate". Mediation, arbitration, expert determination and conciliation all have an important role to play in the resolution of commercial disputes, particularly where there is an ongoing relationship. Disputes clauses can – and should – be crafted to take into account the nature of the contract and the likely disputes which may arise; and
- finally, consider carefully your choice of law provisions in the operating agreement. Most operators (and many owners) have standard agreements which apply globally or regionally. The standard agreement will of course be amended to reflect the commercial terms of the relevant deal. But you should also pause to consider whether the choice of law, and forum for the resolution of disputes, is appropriate. Another jurisdiction may actually be more suitable for the types of disputes which could arise.

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