

Hotel Management Agreements 201 by Hospitality Lawyer - Indemnification Provisions - By Jim Butler, author of [www.HotelLawBlog.com](http://www.HotelLawBlog.com)

2008-07-31

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How to survive some of the custom and 'lore' of Hotel Management Agreement Indemnification Provisions.

While we have a very deep bench of hospitality lawyers -- particularly in hotel management agreements -- my partner, Bob Braun, is one of the most experienced on our team, with several hundred management contracts to his credit, and a dozen or more on his current work schedule at any point in time.

So it was no surprise when he suggested recently that we work together on a few articles going "beyond the basics" of hotel management agreements and post them for our industry friends on [www.HotelLawBlog.com](http://www.HotelLawBlog.com). We decided to call this upcoming series, "Hotel Management Agreements 201." Bob took the lead in putting this first one together on the critical area of INDEMNIFICATION, and here it is.

### **Important background**

#### **Hotel Management Agreements can greatly boost . . . or weigh down . . . hotel values**

The selection of a hotel brand and operator, and the management contract terms, will generally have a determinative impact on the value, marketability and financeability of the property. It is widely recognized that the business and legal terms of the hotel management agreement -- wholly apart from the operator's abilities -- can add or subtract 25% of the nominal value of the hotel, or more. That is huge! And if you make a bad choice in brand, operator or contract terms -- or a good situation turns sour -- it will be difficult or impossible to fix.

#### **Classic resources on hotel management agreements**

If you have not seen it already, the series of articles listed below belongs in your resource library. They focus on "How to Get a Great Operator," starting off with the 5 biggest mistakes owners make in pursuing hotel management agreements (and how to avoid them), and then describing some options for how to run a successful "Hotel RFP."

##### [How to get a great hotel operator - part 1](#)

Hotel management agreement & hotel operator fundamentals

Why management agreements are so important to the value of your hotel

The 5 biggest mistakes owners make in pursuing hotel management agreements (and how to avoid them)

The hotel owner's best friend - the Hotel RFP

##### [How to get a great hotel operator - part 2](#)

What is an RFP?

What critical steps should be included in every RFP?

How does the process work and what do the documents look like?

Isn't there just some form we can see?

##### [How to get a great hotel operator - part 3](#)

5 Factors that determine what your RFP looks like. Is it just a notice to take bids? (NO!)

How we can help you with your RFP

Who does what?

Why it is critical to mixed-use projects?

The 16 Step Program -- steps to a successful RFP Process

Now we turn to another critical component of the hotel management agreement: indemnification provisions.

#### **Hotel Management Agreements 202 - Indemnification Provisions**

##### **Terminology**

Contracts between hotel owners and managers (or operators) controlling the management of a hotel go by various names. They are called hotel management agreements, HMAs, hotel management contracts or hotel operating agreements. For convenient reference, this article will generally use the term "Hotel Management Agreement" or "HMA," but for variety, we will use the terms "hotel manager" or "hotel operator" interchangeably.

Whatever they are called, Hotel Management Agreements allocate risk between the hotel manager and the hotel owner. There are many provisions in the HMA that do this, including reimbursement obligations, termination rights, performance standards and indemnifications. The indemnification provisions in hotel management agreements are particularly important, usually negotiable, and little understood by most business people outside the hospitality industry.

What is indemnification? Indemnification is usually a payment (or sometimes a repair or restoration) made to restore a party to its condition or situation prior to some event. In the context of HMAs, it usually means that one party, typically the owner, will protect another party, typically the manager, from a monetary claim related to the hotel or its operations.

### **Indemnification Provisions in HMAs: What's the fuss all about?**

What does it look like? A simplified indemnification provision in an HMA might look like this:

Owner shall defend, indemnify and hold Operator harmless from and against any and all liabilities, fines, suits, claims, obligations, damages, penalties, demands, actions, costs and expenses of any kind (including legal fees) (collectively, "Claims") arising out of (i) any action or omission or course of action on the part of Operator in its performance under this Agreement, (ii) any obligation incurred by Operator, whether alone or together with Owner or by Owner alone, in connection with the Hotel, and (iii) Owner's breach of this Agreement, provided that this indemnity shall not apply to any Claims resulting from the willful misconduct, gross negligence or bad faith of Operator.

Why is an indemnification provision needed in an HMA? Indemnification is usually attempted to deal with third party claims such as those brought by guests (for lost property or injury), governments (e.g., liquor license or fire & safety violations), or employees (sexual harassment or wrongful termination). It identifies when and how the owner will be responsible for a claim against the manager, and when the manager will be responsible for a claim against the owner.

What does it do that isn't in the rest of the Hotel Management Agreement? It may alter or reverse the "normal" result in third party claims.

For example, in about 80%-90% of current Hotel Management Agreements, the manager is technically and legally the "employer" for the hotel's employees -- the hotel staff and management are on the official payroll of the manager or one of its subsidiaries, and the manager recruits, hires, fires, trains and supervises the employees.

If an employee filed a claim against the manager for discrimination or sexual harassment, the employer would normally be responsible for such claims. After all, it is the employer. But a common indemnification provision might say that the owner has to indemnify the operator against any such claims by employees. Many owners find this extraordinary, inasmuch as any wrongful action would most likely be caused by the manager itself.

The theory of such a common indemnification provision by the owner of the manager is that "the manager is not paid enough to assume this kind of liability." The manager feels that it is just acting as the agent of the owner as an accommodation to the owner, and the owner should pay for all employments cost, benefits, and even such legal claims.

Under the sample indemnification provision above, the owner would probably be liable for any such claims against the manager.

Why should the hotel owner care? When the owner has to pay the first \$5 million judgment for employment discrimination or sexual harassment by the manager --or has it deducted from the hotel's operating accounts -- the owner will care, and will appreciate the importance of the indemnification issue (although it will be too late to change the provision for the duration of the contract).

### **What do hotel operators want?**

Operators generally want to avoid paying any costs incurred in operating a hotel. They want to protect their base and incentive fees from any offsets or reductions, and want to be shielded from any claims incurred in the course of their operating the hotel for the owner. The operator does not want to guarantee any kind of performance or liability. They view the claims that are being indemnified as a normal and ordinary cost of doing business -- claims that the owner would bear if it were operating the hotel itself.

The limited exception that operators are generally willing to make to their complete indemnification by owners, is for a loss that is caused by the hotel operator's own gross negligence or willful misconduct. Operators are also increasingly unwilling to allow "attribution" - where the acts of hotel employees hired and supervised by the operator (which can include the general manager and key, high-level supervisory personnel) are "attributed" or charged against the operator.

In the operator's "perfect world," it has no liability for the negligence of its employees, including the acts of a general manager, unless the owner can show that the negligence was the result of corporate gross negligence or willful misconduct of the operator.

### **What do hotel owners want?**

Hotel owners want operators to manage their property as professionals and experts. They generally do not expect to pay for damages or losses caused by someone else's negligence, breach of contract or violation of law -- much less gross negligence or willful misconduct. In fact, hotel owners want to be indemnified by the hotel operator if the operator causes losses for any of these reasons.

### **What message is being given here?**

The evolution of indemnification provisions mirrors the evolution of hotel management agreements in general. There was a time, not too long ago, when operators WERE responsible for their negligence and misconduct, not just gross negligence and willful misconduct. By industry custom and practice, operators -- at least the established branded operators (as opposed to many independents) -- have reduced their obligations and their liabilities, making management agreements more valuable to them.

For branded hotel operators, this current state of the industry concerning indemnification provisions -- like many other provisions of hotel management agreements sends a difficult message to owners. While managers and owners should be aligned in their goals, this provision highlights the differences and the tension between the positions.

### **How can you resolve it?**

There is no simple answer, each situation is unique. The indemnification provisions cannot be viewed in a vacuum. You need to understand how these provisions relate to the entire agreement, and address indemnification as part of the overall relationship between owner and operator in the hotel management contract.

Unless you are handling hundreds of hotel management agreements a year, so that you know all the ins and outs and current market trends, even professional or institutional hotel investors should not start the management agreement process (even in negotiating the LOI or term sheet) without veteran hotel advisory and legal counsel experienced in these agreements.

### **Putting it all in context. . .**

Hotel Management Agreements (at least such contracts with the branded hotel companies like Marriott, Hilton, Starwood, InterContinental, Hyatt, and the like) tend to be very long term, "no-cut" contacts. Entering one of these arrangements is a little like turning complete control of your asset over to someone on a 99-year lease, except the "rent," if any, depends on what is left over after the manager gets done operating the hotel to its standards. The terms of the hotel management contract are likely to govern the relationship of hotel owner and operator for many decades and are hard to change once cast.

In representing clients in many hundreds of hotel management agreements over the years -- possibly more than a 1,000 -- we find that there is no single one "best" or "right" operator or brand. What's "best" in each situation depends upon each individual client's goals and circumstances, many project-specific facts and circumstances, and the economic environment. It also depends upon the capabilities, vision and strategic needs of a particular hotel brand and operator at a given moment.

### **About the Author**



Jim Butler is recognized as one of the top hotel lawyers in the world. He devotes 100% of his practice to hospitality, representing hotel owners, developers and lenders. Jim leads JMBM's Global Hospitality Group(R) -- a team of 50 seasoned professionals with more than \$40 billion of hotel transactional experience, involving more than 1,000 properties located around the globe. In the last 5 years alone, they have brought their practical advice to more than 80 "hotel-enhanced mixed-use" projects, a term Jim coined to fill a void in industry lexicon. This term describes one of the hottest developments in real estate--where hotels work together with shopping center, residential, office, retail, spa and sports facility components to mutually enhance the entire project's excitement and success.

Jim and his team are more than "just" great hotel lawyers. They are also hospitality consultants and business advisors. They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them. They are a major gateway of hotel finance, facilitating the flow of capital with their legal skill, hospitality industry knowledge and ability to find the right "fit" for all parts of the capital stack. Because they are part of the very fabric of the hotel industry, they are able to help clients identify key business goals, assemble the right team, strategize the approach to optimize value and then get the deal done.

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This article comes from Hotel News Resource

<http://www.hotelnewsresource.com>

The URL for this story is:

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