

Insights

DISPUTES UNDER HOTEL MANAGEMENT AGREEMENTS IN A COVID-19 WORLD – PART I: DEVELOPMENT PHASE DISPUTES

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SUMMARY

The COVID-19 pandemic has wreaked havoc on the hospitality sector, significantly impacting the financial performance of existing hotels and causing delays to new hotel projects. These impacts may result in hotel owners and operators breaching the terms of their hotel management agreements (“**HMA**s”), which could lead to disputes. In this four part series of articles, the team at BCLP examines the likely areas where disputes may arise under HMAs during the hotel’s development and operational phases, as well as key issues for the parties to consider when drafting or reviewing their dispute resolution clauses in the event they wish to invoke the same.

Introduction

The COVID-19 pandemic has wreaked havoc on the hospitality sector, significantly impacting the financial performance of existing hotels and causing delays to new hotel projects. These impacts may result in owners and operators breaching the terms of their hotel management agreements (“**HMA**s”), which could in turn lead to disputes between the parties. In this four part series of articles, the team at BCLP examines the likely areas where disputes may arise under HMAs as well as key issues when considering dispute resolution clauses.

In this Part I, we start our discussion of potential disputes under hotel management agreements by examining typical disputes that may arise during the development phase of the hotel.

Disputes During Development Phase of the Hotel

During the development phase of the hotel, the owner will have various development obligations under the HMA where disputes could easily arise as a result of the COVID-19 pandemic.

Development milestones

The owner is usually obliged to achieve certain development milestones by specific dates. Typical

milestones include:

- commencement of construction;
- practical completion; and
- formal opening of the hotel to the public.

If the owner fails to achieve any of these milestones by the required dates, this may trigger a right for the operator to terminate the HMA as well as a liquidated damages payment in some cases.

With the COVID-19 pandemic causing, among other things, interruptions to the supply of labour and materials, many hotel projects around the world are experiencing delays. This could lead to disputes if operators look to terminate HMAs and/or claim liquidated damages payments for missed milestones.

Whilst most (if not all) HMAs include *force majeure* provisions, there are usually “hard dates” for achieving development milestones, which may not explicitly provide for extensions for any delay due to *force majeure*. If such an extension is specifically permitted, it is often capped e.g. at between 6 to 12 months in aggregate. This is an obvious area for dispute – for instance, whether or not the COVID-19 pandemic constitutes a *force majeure* event and what, if any, length of extension the owner is entitled to. This will depend on several factors, including the governing law of the HMA as well as the specific wording of the *force majeure* provisions themselves.

Brand standards and other opening conditions

The owner is usually obliged to construct the hotel in accordance with the operator’s brand standards. The operator will provide the owner with the brand standards at the outset as well as technical services to assist the owner’s professional team with designing the hotel to meet the brand standards.

The operator will usually reserve the right to refuse to open the hotel under the brand if the hotel does not comply with the brand standards. This could easily trigger a dispute during the COVID-19 pandemic. For instance, if suitable materials are not available forcing the owner to substitute different materials that the operator has not approved or is not satisfied with.

The owner will also have to meet other opening conditions before the operator will agree to open the hotel. These can include:

- obtaining all necessary licences and permits (such as fire and life safety compliance certificates, hotel operating licences, liquor licences and so forth);
- taking out property and operating insurance policies;

- funding the hotel operating account with the initial working capital; and
- ensuring that the hotel is stocked with initial operating supplies and inventories.

Disputes could arise as to whether these conditions have been met, for instance, as a result of delay to the grant of permits or licences, additional or revised legal requirements due to the COVID-19 pandemic (e.g. lower maximum capacity for F&B facilities in the hotel) or trouble procuring operating supplies in time.

Conclusion

As demonstrated above, the owner has many obligations during the hotel's development phase that could potentially be affected by the COVID-19 pandemic and therefore lead to disputes with the operator.

In Part II of this series of articles, we examine the types of disputes that typically arise during the hotel's operational phase and how the COVID-19 pandemic may exacerbate these.

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