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Insights

DISPUTES UNDER HOTEL MANAGEMENT AGREEMENTS IN A COVID-19 WORLD – PART III: KEY ISSUES WHEN CONSIDERING DISPUTE RESOLUTION CLAUSES – CHOICE OF GOVERNING LAW & EXPERT DETERMINATION

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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 ("**HMAs**"), 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 ("**HMAs**"), 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.

With the range of issues that arise during the development and operational phases of a hotel, it becomes ever more important to review the dispute resolution processes in the HMA and clarify whether they are in line with the commercial realities and legal positions that the owner and the operator want to achieve.

This brings us to three potential considerations in the context of the dispute resolution regime.

The first is choice of governing law of the agreement. The parties typically choose their governing law based on familiarity, jurisprudence or indeed, convenience. With COVID-19, parties have had both the fortunate and unfortunate endeavours of finding out how their choice of law has enabled or diminished a claim. In this Part III, we take a look at some of that impact and emphasise the importance of choosing wisely.

The second and third considerations both fall within the ambit of the dispute resolution clause itself and the specific dispute processes in the HMA. In this Part III, we discuss the second consideration, expert determination, and touch on pertinent considerations when drafting this provision and addressing the expert's scope.

In Part IV, we will conclude this series of articles by discussing the third consideration, the arbitration clause, and some of its key tenets.

Choice of law

When parties enter into contracts, they are often thinking of the certainty of the contractual bargain. No doubt that must be correct for the legal formation of an agreement in the first instance. In a common law system (e.g. Singapore law, English law), the sanctity of contract is upheld even if the allocation of risk "unfairly" shifts to one party during the term of the contract. Parties are generally expected to live and die by the sword of their contractual clauses, unless a common law doctrine such as frustration can be invoked to shield them from the consequences.

In a civil law system (e.g. Indonesian law, Vietnam law) however, parties may be able to rely on the principles of good faith, doctrine of unforeseeability and judicial intervention where there are unforeseen circumstances which impose an excessive burden on one of the parties.

In the context of COVID-19, this has impacted the invoking of, for example, the *force majeure* clause and/or doctrine as discussed under our section on development milestones. Under common law, *force majeure* is a creature of contract and if the contract does not contain such a clause, parties will not be able to rely on this event. Under civil law, there may be a provision for *force majeure* or material adverse change in the relevant civil code, and parties can look to that to possibly set aside or terminate a contract notwithstanding that the agreement itself is silent on those clauses.

This can have major consequences where a *force majeure* clause is not provided in the contract (less common) or when the scope of the clause is not wide enough to cover a certain event or provide the necessary relief to parties. That being said, parties will do well to consider carefully how their *force majeure* clauses are drafted, regardless of whether a contract is subject to a common or civil law system – given in particular its close correlation to whether an operator may exercise its termination rights under the HMA.

Apart from the above, the governing law may also have an impact on the interpretation or cap on liquidated damages. For example, there are countries where local laws cap the amount of liquidated

damages at a certain percentage of the contract sum, notwithstanding what is provided for in the contract. This again could have an impact on the liquidated damages an operator can impose on an owner if there is a delay in achieving development milestones, which may become increasingly common.

These are just two examples of how the choice of law can have an important bearing on the interpretation and limitations of contractual terms. The owner and the operator should therefore consider carefully the different legal outcomes and obligations that may arise when making this choice.

Expert determination

Expert determination is a common way to resolve disputes in a HMA and is in fact also frequently seen in disputes concerned with the construction, intellectual property and energy sectors. In some of these sectors, expert determination rules (such as those issued by the Singapore Institute of Architects and the IPOS-WIPO Centre) provide a procedural basis on which the expert determination is conducted. However, such rules have not been issued for the hotel sector so the owner and the operator must rely on the expert determination provisions in the HMA.

In the context of resolving disputes, expert determination is often seen as a cost-effective and efficient method to address discrete technical and operational questions, which bears benefits in a long term relationship where parties continue to work together. Given that this process is entirely a creature of contract and is not governed by rules of court or statute, it behoves parties to craft this clause with some detail.

Firstly, the expert panel and the remit of the expert. Typically, the expert appointed is required to have at least 10 years' professional experience in the industry as well as specific experience regarding the subject matter of the dispute. The parties may go further and also provide that the expert has not worked for either of the parties within a certain period of time prior to their date of appointment, to help ensure their independence. There are a number of large international hospitality consultancies that operate throughout Asia Pacific, so finding an expert that fits these criteria shouldn't be too difficult.

As to the conduct of the determination process, it is important to establish at the outset a procedure, as well as what the expert is required to do in the course of their determination. Apart from defining those matters in which the expert is to act, it is common to include provisions such as the expert being required to make their decision based on all the evidence before them, the nature of submissions and responses to submissions, the type of hearing, if any, and the timing for the expert's decision. This should help the parties avoid disputes as to what the process should be at the point where expert determination is invoked.

Secondly, the scope of disputes to be resolved under expert determination. These are typically limited to disputes relating to the annual budget and any performance test or guarantee.

This begs the question as to whether, in view of COVID-19 and its uncertainties (or even without), parties are open to expanding the scope of disputes to be addressed under expert determination. Applying the notion that this alternative dispute resolution mechanism produces timely and less costly outcomes when administered to the right types of issues (right being imperative), it may be worth considering whether other potential issues under the HMA can be brought under this umbrella; including, more frequently, disputes related to development milestones and brand standards. However, where there are complex legal issues involved in the dispute, this may be better left to arbitration.

Thirdly, the finality of the determination. Broadly, expert determinations are expressed to be final and binding, which means they are not open to appeal unless the expert had acted *ultra vires* the contractual scope, materially departed from their instructions or there is an element of fraud. This is why it is important, as mentioned above, to establish the powers and remit of the expert. If parties wish to expand the grounds on which they can challenge the determination, then this should also be explicitly provided in this clause.

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