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# Designer Hotels Are In Fashion: But Care Should Be Taken To Avoid A Major Faux Pas

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In 1990, the Italian designer, "Krizia" Mariuccia Mandelli, known for Krizia and Krizia Uomo lines, opened the Krizia K Club on the Antiguan Island of Barbuda in the West Indies. Since that time, a parade of designers have given permission for the use of their labels in the hospitality industry: Diesel (South Beach, Miami), Versace (Palazzo Versace in Queensland, Australia and Versace Palazzo in Dubai, United Arab Emigrates), Ferragamo (Lungarno Hotels in Florence, Italy), Armani (Dubai and Milan in 2008), Bulgari (Milan and Bali) Ralph Lauren (the Round Hill Hotel and Villas Resort in Jamaica), Anouska Hempel (The Hempel (London) and Blakes Hotels in Amsterdam and London); Antonio Miro (Hotel in Bilbao, Spain), Todd Oldham (The Hotel in Miami, Florida); and John Rocha (The Morrison Hotel in Dublin, Ireland). Each of these luxury hotels involves a great deal of foresight and planning in locations around the world.

The move by international fashion labels into the hospitality industry is a logical extension of the strong brand awareness accorded high profile designers and their fashion brands. Fashion designers can greatly enhance a property by lending the cachet and prestige of their brand name as well as through their design talents. The hotel experience gives the designer a perfect platform for advertising and marketing the lifestyle and high luxury that are represented by their brands. Numerous consumers visiting designer hotels or frequenting the five star facilities are permitted to experience and spread the word and image of lifestyle of the designer's brand. or example, the Palazzo Versace with its gold lion heads, roman columns and vibrant prints celebrates all that is Versace.

But care must be taken to avoid potential liability that may arise from the application of fundamental agency principals to the hotel management agreement. Recently, a jury in Maryland in the United States District Court for the District of Maryland found for the owner and held that Ritz Carlton (and Marriot International) had breached in hotel management agreement and its fiduciary duty by building a new Bulgari-branded hotel only seven kilometers from the Ritz Carlton Bali Resort & Spa under which Ritz Carlton served as an agent. The jury awarded $382,304 in compensatory damages and $10 million in punitive damages, plus attorney's fees. (1)

The Bulgari decision is a serious reminder that, while the hotel management agreement is the cornerstone of the business relationship, including setting forth the parameters for the branding, the guest perception, financing, ownership structure and day-to-day operations, courts will apply common law agency principles, which may, contrary to the language in the agreement, impose fiduciary obligations or to provide for termination of a hotel management agreement if it can be shown that the operating firm has breached the management agreement or its fiduciary duty to the owner. This is not the first result of this type. In fact, there has been a long line of cases which involved similar findings.

For example, recently in 2660 Woodley Road Joint Venture v. ITT Sheraton Corp., a jury in the United States for the District of Delaware awarded almost $15 million in actual damages and over $37.5 million in punitive damages against ITT Sheraton Corp. based upon its alleged breach of its management agreement and fiduciary duties and claims asserted relating to its use of a Sheraton purchasing program and failure to pass volume discounts on to the owner. While the damages awards were reduced on appeal and the Third Circuit Court of Appeals held that the evidence did not support an award for breach of agency provision of the management agreement, the Third Circuit nevertheless upheld the termination of the management agreement, notwithstanding the fact that the management agreement had "no cut" provisions. In Woodley, the district court held that the owner had the power to terminate the agency relationship, especially where the evidence demonstrated that the operator had received "kickbacks" and "commercial bribes" from its vendors but had not shared these benefits with the owner. The Third Circuit Court of Appeals affirmed in part and remanded the case and vacated the $10,260,000

award for breach of contract, affirmed the award for breach of fiduciary duty and reduced punitive damages to $2,025,000.

Any breach of a fiduciary duty by the hotel operator might lead to a similar result. This is significant because licensors or franchisors in the hotel industry may no longer rely solely on a contractual provision to deny that an agency relationship exists or to state that the management agreement may not be terminated. The only exception to this general rule is where the "power is given as a security" or "[a] power is coupled with an interest" for the benefit of the managing party. See Government Guarantee Fund of the Republic of Finland v. Hyatt Corp., 95 F. 3d 291 (3d Cir. 1996); Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc., 19 Cal.App.4th 615, 624-25 (Court of Appeal, 4th Dist. 1993). A principal may grant an irrevocable agency power for the purpose either of furnishing a security to protect a debt or other duty, or facilitating the performance, effectuating the objects, or securing the benefits of a contract. Restatement (Second) of Agency (1950) Â§ 138 cmt. c)). Essentially, an agent must have some owned interest in the hotel for a management contract's provision stating that the agency is irrevocable to be effective. The existence of a franchise with a brand name has been held to be not enough because franchise agreements are generally severable and independent from the management contracts and different hotels may be managed by others. See, e.g., Woolley v. Embassy Suites, Inc., 227 Cal.App.3d 1520, 1533 (Court of Appeal, 1st Dist. 1991).

This relationship in the profession of hotel management is different from other licenses or franchise agreements. In a litigation context, the court will look at the actual obligations and actions to determine the actual nature of the parties' relationship. Courts, and perhaps more importantly, juries may look beyond the actual terms of the contracts to the relationship between the parties and the history of performance to determine the nature of the relationship that exists and the duties owing under the relationship. Unlike a typical franchise or license, barring the unlikely existence of an agency coupled with an interest, the case law will usually permit the owner to revoke the agency and terminate the management agreement at will. Notwithstanding strict termination clauses in the management contract and the subordination agreement with the creditor, the hotel owner nevertheless is still allowed to revoke the agency. Once the revocation has been made, the manager will be required to vacate the premises upon the request of the owner.

As a result, care must be taken in draft the hotel management agreements to counsel clients as to the possible risks and liabilities associated with the structure and nature of the relationship and agreement. In addition, both the owner and the hotel management company need to take care that there are no risks associated with the transaction and no possible issues that may subject the management company (and the owner of the second hotel property) to potential liability or risks associated with another hotel property in the vicinity. The recent jury decision in Karang Mas Sejahtera (KMS) v. Ritz Carlton Co. LLC is a reminder of the important differences between a "power coupled with agency" and a terminable agency agreement and the risks that may result if care is not taken in understanding pre-existing relationships and these basic agency principles.

[1] Karang Mas Sejahtera (KMS) v. Ritz Carlton Co. LLC, (D. Md. February 5, 2008). Post trial motions have been noticed and it is possible that this matter will continue until the pending motions are resolved and the right of appeal exhausted.

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