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Arbitration Provisions in Hotel Management Agreements


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Virtually all hotel management agreements contain arbitration provisions through which both the hotel owner and manager have agreed to resolve their disputes through private dispute resolution rather than publically, in court. As we have explained in prior articles, when a hotel owner hires a hotel management company to operate its hotel and executes a hotel management agreement (HMA), there invariably exists some tension between the operator and owner with respect to the operator's responsibilities for the successful operation of the owner's hotel.

As a result, HMA's often contain a number of dispute resolution provisions, some of which are designed to resolve specific, acute issues such as disagreements over line items in an annual budget, while others are broadly tailored to resolve global problems with an operator's management of the hotel, including those that result in a default being declared under the HMA. As such, some alternative dispute resolution provisions are structured to reach a quick solution, while others naturally cause the parties to engage in a more lengthy procedure, with discovery, motions and hearings before a final determination can be reached. And even with a number of alternative dispute resolution procedures and protocols in the management agreement—in part tailored to expedite resolution but also largely motivated by keeping disputes confidential and preventing the owner and operator from airing dirty laundry—there are still carve-outs in the agreements for the owner or operator to commence an action or proceeding in court.

With multiple dispute resolution provisions often being set forth in a single agreement, it is unsurprising that there are frequently disputes between hotel owners and operators about which alternative dispute resolution clause, if any, governs the dispute presented. Thus, the improper invocation of a particular dispute resolution clause or the failure to employ the correct resolution provision often results in the parties litigating, in court or before the arbitrator, about the arbitration procedure itself, before getting to the merits of the underlying dispute.

This article examines the course that hotel owners and operators may chart in determining which, if any, alternative dispute resolution clause will apply to the parties' dispute, including analyzing how courts have applied the Federal Arbitration Act in interpreting such arbitration provisions, and who, in the first place, decides whether a dispute is subject to a particular arbitration provision in the management agreement or arbitration at all.

Types of Provisions

As stated above, the spectrum of disputes that a hotel owner and operator may encounter during the term of the HMA is broad and varying both in materiality and necessity for fast resolution. As a result, most HMAs have a number of dispute resolution procedures and it is up to the owner or operator to identify and invoke the appropriate provision.

First, virtually all HMAs contain a global, all-encompassing provision that directs "any and all disputes arising out or relating to the agreement" to arbitration. This provision will typically be the central arbitration provision and will outline the exact procedure and protocol that must be followed by the parties in order to gain entry to an arbitration tribunal such as the American Arbitration Association (AAA) or JAMS, including setting out any timelines, notice requirements, or precondition obligations to negotiate or mediate in good-faith before proceeding to arbitration itself.

Frequently, this broad arbitration provision is prefaced by a qualifying clause to the effect that the foregoing provision is to be applied "unless specifically provided for otherwise in the agreement." Thus, if there is a distinct dispute resolution mechanism contained elsewhere in the agreement that applies to a specific, narrow dispute, then the parties are required to invoke that narrow procedure. Typically, when disputes concern business plans or budgets—which involve some of the few hotel matters over which the owner has approval or consent rights—the owner and operator agree to have these disputes resolved by a specific expert in the hotel industry and on an expedited basis, given the time-sensitive nature of finalizing business plans and budgets.

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With respect to disputes relating to an alleged event of default and grounds for termination of the HMA, the parties are typically directed to the agreement's general arbitration provision. However, a popular addition to many recent HMAs is a clause that provides for a stay of the termination of the HMA resulting from an event of default pending the outcome of the arbitration, provided that the operator properly and timely commences the arbitration. Such a clause is directed only at termination based upon alleged events of default, and as we have indicated in our past articles on the subject, does not impede or infringe upon an owner's unfettered right to terminate the HMA and operator based on principal-agent and personal services contract principals notwithstanding the existence of any pending arbitration.

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If the procedural morass could not get more complicated, the parties still have the right to commence an action or proceeding in court under certain limited circumstances, usually which are in aid of the arbitration, such as: to seek mandatory, declaratory or injunctive relief to define or protect the rights of the parties pending the dispute; to enforce the obligations in the management agreement pending the dispute; or to enforce an arbitration decision or award.

Identifying the Correct Forum

Who decides if a dispute is subject to a particular arbitration provision, or arbitration at all? The consequence of invoking the incorrect provision will frequently result in a dispute over the applicability of the arbitration provision itself, before even getting to the merits of the dispute. The objections that can be raised include (i) that the subject of the dispute does not fall within the scope of a particular arbitration provision, or arbitration at all, or (ii) the party failed to follow the procedural prerequisites to gaining access to arbitration. The first question, therefore, is where does a party raise these objections to arbitration: before the courts or the arbitrator?

"[A] gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide."[1] Thus, where a disagreement exists as to whether a dispute resolution provision is narrow or broad enough to encompass a particular claim—termed "substantive arbitrability"—that is an issue of arbitrability for the court, not the arbitrator, to resolve.[2] While an issue about whether a party followed certain procedural conditions precedent to invoking an arbitration provision—termed "procedural arbitrability"—is for the arbitrator, not the courts, to decide.[3]

For example, in *New Avex v. Socata Aircraft*,[4] a dispute arose concerning whether one party engaged in the requisite three-months of good-faith negotiations prior to commencing arbitration. The court held that whether or not the party met the pre-conditions to commencing arbitration was a question of procedural arbitrability for the arbitrator to resolve. In *Unis Group v. Compagnie Financiere de CIC et de l'Union*,[5] the court held that whether or not a party served a notice of its intent to arbitrate also presented an issue of whether a condition precedent had been met and thus, was one of procedural arbitrability for the arbitrator to resolve.

And in *Town Cove Jersey City Urban Renewal v. Procida Construction*,[6] the court held that whether or not a party appropriately referred a dispute to be resolved by an architect prior to submission of the dispute to an arbitrator presented a procedural issue for the arbitrator, not the court, to decide.

Notwithstanding the above law, the parties can still agree to have all issues of arbitrability—including substantive issues about whether a dispute should be arbitrated in the first place—submitted to an arbitrator if there is "clear and unmistakable evidence from the arbitration agreement" that the parties intended the issue to be heard by the arbitrator.[7] Indeed, to refer all arbitrability issues to an arbitrator all the parties need to insert in the HMA is a provision that they agree to submit the controversy to the AAA in accordance with the association's rules. Because Rule 7 of the AAA's Commercial Rules states that "the arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement,"[8] Courts have held this means the parties have clearly and unmistakably evidenced their intention to have all issues, both substantive and procedural, resolved by the arbitrator.[9]

Therefore, the parties can avoid any dispute as to who decides questions concerning arbitration by including reference to the AAA's Commercial Rules.

How Clauses are Interpreted

Once the correct forum has been identified, the next question is how will the court or the arbitrator analyze whether a particular dispute is subject to a particular arbitration provision or arbitration at all.

The interpretation and application of HMA arbitration provisions, in the majority of circumstances, will be governed by the Federal Arbitration Act.[10] In the U.S. Court of Appeals for the Second Circuit, a three-part test has been developed for determining whether a certain dispute is within the scope of an arbitration provision and therefore, must be submitted to arbitration:

> (1) the district court must first determine whether the arbitration clause at issue is broad or narrow; (2) if the clause is narrow, the court must determine whether the particular dispute involves a matter that is on its face within the purview of the clause or a collateral matter; and (3) if the court determines that the arbitration clause is narrow and the particular dispute involves a collateral matter, the court should not compel arbitration of that dispute.[11]

A broad clause is one that refers all disputes to arbitration—such as where the clause provides for the arbitration of "any claim or controversy arising out of or relating to the agreement"[12]—while a narrow clause limits the arbitration to specific types of disputes.[13] If an arbitration clause is narrow, the court must interpret the clause specifically and with its limited intent,[14] while if the arbitration provision in the management agreement is broad the court is required to compel arbitration "of the entire dispute, including collateral matters."[15] "[A]ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."[16]

Given the heavy presumption in favor of resolving disputes via arbitration, it is likely that the way most arbitration provisions are crafted in HMAs, any dispute that arises between an owner and operator will be resolved by expert resolution, mediation and/or arbitration. If an owner does not want to be confined to private, alternative dispute resolution, it is critical to make express provision for resolution of disputes through litigation, rather than arbitration.

Conclusion

One of the last things that hotel owners and operators want to consider when commencing a business relationship is the procedure that will be invoked for how the parties will resolve disputes or ultimately terminate their association.

However, based upon the procedural and substantive complexities attendant with alternative dispute resolution provisions in HMAs—and the lengthy amount of time that can be spent fighting about procedure before getting to the merits of the underlying issues—there are important strategic considerations involved in crafting arbitration provisions in the first instance and then fighting them to achieve certain business objectives.

1. *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 85 (2002).
2. *Collins*, 58 F.3d at 20; *Mehler*, 205 F.3d at 49; *Louis Dreyfus*, 252 F.3d at 224.
3. *BGGroup PLC v. Republic of Arg.*, 134 S. Ct. 1198, 1207 (2014); *John Wiley & Sons, Inc. v. Livingston*, 84 S. Ct. 909 (1964).
4. 2002 WL 1998193, at *6 (S.D.N.Y. Aug. 29 2002).
5. 2001 WL 487427, at *2 (S.D.N.Y. May 7, 2001).
6. 1996 WL 337293, at *3 (S.D.N.Y. June 19, 1996).
7. *Contec Corp. v. Remote Solution*, 398 F.3d 205, 208 (2d Cir. 2005).
8. American Arbitration Association Commercial Arbitration Rules and Mediation Procedures Rule-7 (a) (Oct. 1, 2013).
9. Contec, 398 F.3d at 208.
10. 9 U.S.C. §1 et. seq.
11. *Manos v. Geissler,* 321 F. Supp. 2d 588, 592 (S.D.N.Y. 2004); *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading*, 252 F.3d 218, 224 (2d Cir. 2001).
12. *Collins & Aikman Prods. v. Building Sys.*, 58 F.3d 16, 20 (2d Cir. 1995); Mehler v. Terminix Int'l Co., 205 F.3d 44, 49 (2d Cir. 2000).
13. *McDonnell Douglas Finance v. Pa. Power & Light*, 858 F.2d 825, 832 (2d Cir. 1988); ACE Ltd. v. CIGNA Corp., No. 00 Civ. 9432 (WK), 2001 U.S. Dist. LEXIS 9240, at *8 (S.D.N.Y. July 6, 2001).
14. *Prudential Lines v. Exxon Corp.*, 704 F.2d 59, 63-64 (2d Cir. 1983); *Camferdam v. Ernst & Young Int'l*, No. 02 Civ. 101000 (BSJ), 2004 U.S. Dist LEXIS 9092, at *5 (S.D.N.Y. May 17, 2004).
15. *Manos*, 321 F. Supp. 2d at 593; *Louis Dreyfus*, 252 F.3d at 224.
16. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).