

# Hotel Management Agreement Disputes in the UAE. What are the Options?

by Robert Karrar-Lewsley - r.lewsley@tamimi.com -

September 2014

The relationship between the hotel Owner and the hotel Operator is usually a happy one. Both parties have an interest in working together to ensure the hotel succeeds and is profitable.

The arrangement is governed primarily by a hotel management agreement ('HMA'), which is usually for a long duration (greater than 20 years) and will contain detailed provisions so as to make clear the parties' respective rights and obligations and avoid misunderstandings and disputes.

Nonetheless the relationship is complex and not without inherent tension. During the life of the HMA the market will inevitably fluctuate, and the Owner will be concerned that the Operator is managing and marketing the hotel well, responding to changes in the market and not becoming complacent. Meanwhile the Operator will want to ensure the Owner continues to invest in the maintenance of the hotel and does not interfere with its operation. There is also the risk that one party will become disenchanted with the fee arrangements or occupancy rates and seek to renegotiate the payment terms or generate a pretext to enable termination.

This article considers some particular issues that arise from the management of hotels in the UAE, and which should be kept in mind by the parties before entering into the HMA.

## **HMA's in the UAE**

HMA's in the UAE tend to be governed either by UAE law or English law. As explored further below, this can have important repercussions for the rights of the parties when disputes arise and the type and scope of damages that can be recovered.

Where the parties choose English law (or any other non-UAE law) then they must also choose arbitration because in practice the UAE courts do not apply foreign laws. Even if the governing law is that of the UAE, most HMA's will nonetheless contain an arbitration clause because arbitration is often considered a neutral forum, and one that will be in a language and format familiar to at least the Operator (and often the Owner as well). The complexities of the relationship and the issues that arise are also arguably better dealt with at arbitration because the parties have an opportunity to choose sophisticated arbitrators experienced in such matters.

## **Interim Injunctions**

In Western jurisdictions it is often the case that prior to the issuance of a final judgment, a party can seek an interim injunction from the local court to force the other party to do or refrain from doing a certain action pending the court's final decision on the dispute. For example, an Operator might seek an injunction restraining the Owner from continuing to use the Operator's signage, or an Owner may seek an order that the Operator continue operating the hotel.

Technically, this type of relief is available from UAE courts. The courts have broad powers and parties can file applications to request that they exercise them. However, in practice whilst the courts may seize and attach assets before a final judgment is made, they very rarely if ever grant

interim orders compelling a party to do or refrain from doing something before final judgment is issued. The position taken by the courts is that if a party is behaving wrongly, the appropriate remedy for the aggrieved party is damages; if the party continues to behave wrongly, this simply increases the other party's claim for damages.

It is possible that during an arbitration the Tribunal may issue an order directing one party to take certain actions, and often a party will voluntarily comply with the order rather than defy the wishes of the Tribunal. But if not, then a party would have to seek enforcement of the order through the local UAE courts. Although technically possible, there have not been any recorded cases of such an attempt being successful.

The unavailability of interim injunctions means that both parties can find themselves in situations in which they are desperately unhappy with the current state of affairs and may be suffering loss and reputational harm, but must either endure the situation until the dispute is formally resolved (which may take many months or years), or reach an alternative solution with the opposing party. These issues are now discussed in greater detail below.

### **Disputes over fees**

The conventional arrangement in an HMA is that the Operator handles the financial operation of the hotel. Each month its fees are determined in accordance with the fee structure agreed in the HMA, and the Operator is then paid from the operating account by the hotel's General Manager (technically an employee of the Owner but appointed and loyal to the Operator).

Disputes over fees rarely occur, but they do happen. Sometimes, either by design or accident, a situation emerges whereby the Owner has control of the hotel finances and withholds payment to the Operator or fails to provide additional working capital in circumstances where the hotel has made a loss so that fee cannot be paid. On other occasions, the Operator may try to engineer a default so that it has a pretext to terminate a long-term agreement (as a failure to pay is a relatively easy contractual breach to claim and prove).

When disputes do arise it is often the Operator that is most exposed because it may find itself obliged to continue operating the hotel (for the sake of its brand if nothing else) despite not being paid. It is sometimes difficult for the Operator to countenance bringing arbitral proceedings because the costs of such proceedings may be high, and such a claim will usually destroy whatever was left of the relationship between the parties. However, it is also a situation that the Owner cannot allow to continue for very long as the smooth running of the hotel and its profitability may be adversely affected.

These types of disputes are therefore generally resolved through negotiation, with the Operator continuing to operate the hotel and seeking to preserve the relationship. If however the outstanding fees keep accruing then the Operator may well reach a level at which arbitrating or litigating the dispute becomes inevitable, although this is rare in our experience.

A practical step sometimes taken by an Operator to elevate the issue is to stop operating the Hotel, thereby placing pressure on the Owner to resolve the matter. This is however a risky tactic, although it may succeed in forcing the Owner to enter into serious negotiations sooner rather than later. The tactic is risky as the Operator's reputation may be tarnished by a refusal to perform, even though under UAE law it may arguably have a right to take such action (Article 247 of the UAE Civil Code states that if one party refuses to perform the other party may also withhold performance).

An Operator should also be aware that under UAE law it may find itself liable to cover the losses sustained by the Owner as result of the refusal to operate the Hotel. Article 106(2)(c) of the UAE Civil Code states that the exercise of a right is unlawful 'if the interests desired are disproportionate to the harm that will be suffered by others'. This means that if ceasing operation will cause

disproportionate harm to the Owner (which it often will), the Operator may be liable to compensate the Owner for this loss.

The best approach for an Operator may therefore be to negotiate a settlement, or once the outstanding fees become too great, to terminate the HMA and sue for damages, but such a step is not without risk and requires careful legal advice.

### **Unlawful Ejection of the Operator**

Even when there is a total breakdown between the Owner and Operator, it is rare for the Operator to be unlawfully ejected from the premises, but it can happen.

The reason it is rare is because both parties have a strong incentive to ensure that even if the relationship has ended, any handover in operation is smooth. The Owner wants the operation of the hotel to be unaffected by the handover, and will need the Operator's cooperation to achieve this; the out-going Operator will want to remove its signage and ensure any outstanding fees are paid without hassle.

However, there have been cases where the working relationship collapses to such an extent that the Owner has ordered the Operator to leave and effectively seized operation of the hotel, transferring it to a new operator or operating the hotel itself under the old operator's brand. This may expose the Owner to a significant claim for damages by the Operator, who will likely claim, amongst other things, many years of lost profits.

The difficulty for the Operator in these situations is that, whilst it may have a good claim for damages against the Owner, it is not possible to get an order forcing the Owner to remove the signage without first obtaining a court judgment (or ratified arbitral award), which will take time. If the Operator unilaterally attempts to remove its signs the police may be called and the Operator prosecuted for trespass. Resolving the dispute by formal dispute resolution (i.e. arbitration or litigation) is likely to be the only course of action available. If the ejection was carried out without any lawful prior termination then the Operator will likely have a good case.

### **Termination and Liquidated Damages**

HMAs often contain clauses stating that the Owner can terminate the agreement early for convenience, but that if this right is exercised some damages or fee must be paid to the Operator. This may be a set figure and/or an amount calculated on the basis of the profits generated over previous years.

The difficulty is that if the HMA is governed by UAE law such clauses may not be entirely upheld. Article 390 of the UAE Civil Code states that parties may fix the amount of compensation in advance, but that 'the judge may in all cases, upon the application of either of the parties, vary such agreement so as to make the compensation equal to the loss'. This is based on the Sharia notion that compensation must be equivalent to the damage in fact suffered and not be made subject to chance.

In order to get around this, some parties try to carefully word such provisions so as to suggest that one party is paying a fee to the other for the right to terminate, rather than the payment being a penalty or a pre-estimate of damages. The UAE Courts however will likely look to the substance of the arrangement rather than its form and use its right under Article 390 to reassess damages if one party requests it.

This does not however mean that such clauses are redundant. The courts are generally willing to consider the agreed figure as an accurate assessment of damages and it will be for that party trying to reopen the assessment of damages to prove the actual loss. This usually shifts the burden on to

the Owner, who may sometimes struggle to prove what the Operator's losses were. The Operator can also apply to reopen the assessment if it believes its losses were in fact greater than the amount agreed in the HMA.

If the governing law is English law, then such clauses have a far better chance of being upheld. English law will in principle respect a liquidated damages clause, provided it does not constitute a penalty clause.

### **Problems faced by the Owner**

The above may suggest that it is the Operator who is more exposed when the relationship deteriorates, but this is not the case. In many ways the Owner has more to lose, since it will have invested greatly in the asset, often spending tens of millions of dirhams fitting out and designing the hotel to meet the stringent demands of the Operator. The Owner expects to recover this significant investment over the long term of the agreement, so an early dispute with the Operator can result in huge losses.

Equally the Operator should be careful to undertake all that is required of it under the HMA because if the Operator breaches the agreement such that the Owner is entitled to terminate, the Operator may be liable to compensate the Owner for the huge losses the Owner may suffer in changing signage and meeting the standards of a new replacement operator.

The HMA should clearly state the Owner's rights to terminate in the event of poor performance by the Operator. If the HMA is terminated the Operator will often make arrangements to leave, but if not the Owner may have to seek a court order to force them out. Since interim injunctions are not available, this will mean initiating arbitral proceedings or court proceedings, depending on the HMA's dispute resolution clause. This can result in the difficult situation where the Operator continues to operate the hotel, and uses the fees generated to fund its legal fight against the Owner.

In the UAE the police are unlikely to force the Operator to leave without a court order, although proof that the HMA has been terminated may in such situations be sufficient. More often than not however the police will view the matter as a civil disputes and decline to become involved.

In circumstances where the Owner has concerns about the financial running of the hotel, it is possible to approach the local court to have a Guardian appointed. The Owner will need to demonstrate to the court that the situation is urgent and that there is a genuine fear of significant financial loss. A Guardian will supervise the financial running of the hotel to make sure that it is being run appropriately until the dispute is resolved. The problem with this option is that will take at least 6 months for such a Guardian to be appointed, and although the parties can jointly nominate the Guardian, if they cannot agree or the court refuses in its discretion to accept the nomination, the court will appoint the Guardian with no guarantee that the Guardian will be effective.

### **Mediation**

Prior to starting any arbitral or court claim, the parties should carefully consider whether mediation might be more effective in resolving their dispute. Although mediation does not result in a binding award or judgment, it more often than not can result in an amicable agreement which resolves the dispute in way that is quicker and cheaper than arbitration or litigation. It does however depend on both parties having a genuine desire to consider compromising their positions, and may not be suitable in all cases.

### **Conclusion**

Given the complexity and length of an HMA, it is inevitable that disputes will arise. Most of these

matters are dealt with amicably by the parties, as provided the hotel is reasonably profitable both will stand to lose more if the relationship ends. Terminating an HMA should always be seen as a last resort, and should only be done after taking detailed legal advice.