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Management-contract squabbles overshadow mutual need

By Jeff Higley
EDITOR-IN-CHIEF

LOS ANGELES—The natural tension between hotel owners and management companies that operate their hotels is good for the industry, but both sides can't lose sight of the fact that they need one another, according to participants in a Lodging Industry Investment Council roundtable.

The roundtable, one of two sponsored by HOTEL & MOTEL MANAGEMENT, was held in January in conjunction with the Americas Lodging Investment Summit.

Jim Butler, vice chairman of LIIC and chairman of the global hospitality group with the Los Angeles law firm Jeffer, Mangels, Butler & Marmaro, said the relationship between owners and operators is probably as tense as it has been since the early 1990s, when there were many foreclosures.

"There are probably three results of that," Butler said. "One we're already seeing, which is the bloom of litigation between owners and operators over existing long-term contracts where owners are either seeking damages for breaches of fiduciary duty and/or termination of the long-term agreement. Second, the operators will move quickly to fix those problems in their contracts because most of the liability can be fixed.

"The problem is that it will swing the terms of the management agreement to become far more onerous to owners and that probably leads to the third area, which is creation of tremendous opportunities for operators who are willing to justify their relationship on a more performance- and satisfaction-guarantee-type basis instead of the long-term view."

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Steve Van of Prism Hotels and Remic Hotel Management said some owners are looking for scapegoats.

Steve Van, president and c.e.o. of Prism Hotels and Remic Hotel Management Co. in Dallas, said his company has been asked to make management proposals from several owners of large hotels who are unhappy with their management.

"Part of it has to be that they're just looking for a scapegoat or they're unhappy. But the other part is they're looking for some leverage to get deals from management companies willing to put their fees where their projections are," Van said.

The capital providers participating in the roundtable said they obviously have a vested interest in owner-management squabbles, but for the most part are sitting on the sidelines waiting for the issue to be resolved.

"It's always been a quagmire," said Bernie Siegel, managing director-hospitality division for Denver-based Secured Capital Corp. "For the larger institutional properties, lenders absolutely prefer a chain-affiliated manager. However, in a default, they would love to be able to replace that manager. And usually, big chains will not allow both. That will reach a heated level of negotiations going forward in this environment."

"I swore in 1993 that if the economy ever came back that no lender would ever make a loan again without having the right to terminate the operator," said Frank Nardozza, chairman and c.e.o. of Fort Lauderdale, Fla.-based REH Capital Partners. "Everyone forgot there were problems in being able to sell an asset encumbered with a long-term management contract. It still doesn't seem to be, from the lenders we encounter, as big an issue as I would have thought."

A trickle of lawsuits two years ago—several of which were filed against Marriott International—has turned into a plethora of litigation. There's no exact count available of how many lawsuits have been filed by owners against management companies, but Nardozza said it appears to be getting out of control.

"There's a cookie-cutter process going on in the industry and everyone is trying to jump on the bandwagon," he said. "If you look at the complaints that are being filed on all these deals across the country that are now filtering down to secondary-sized management companies from their owners, they look exactly like the suits against the major companies. They have the same wording in them. I'm getting at least two calls a month from people wanting us to be expert witnesses in these deals.

"A lot of this talk about this very hostile environment is really just a lot of players out there trying to stay covered," Nardozza said.

Sean Hennessey, director-hospitality and leisure practice for PricewaterhouseCoopers in New York, concurred.

"We've dealt with a couple of owners who say, 'I've seen what's been in the headlines with some of the big companies, and I'm not as big as them. But I feel like I still have to report to my board, and it's incumbent upon me to at least explore whether we have an issue in this area or not regardless of whether we go to a lawsuit or whatever,'" Hennessey said. "Everyone feels like they have to look at it. They just can't ignore it."

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Greg Casserly of Tarsadia Hotels said tension between hotel owners and managers is overblown.

Greg Casserly, president and c.o.o. of Costa Mesa, Calif.-based Tarsadia Hotels, said the issue is overblown.

"Maybe I have a more regional view of this, but I don't really see the tension," Casserly said. "There are a couple of guys who get a lot of press. But at the end of the day, if you have a decent approach to doing business, you can't really buy any asset of reasonable size without having some kind of relationship with a national lodging company. If you're going to be in the business and you're going to buy significant, substantial assets, it's incumbent upon you to have good relationships with those lodging companies."

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LIIC's mission

The Lodging Industry Investment Council is an industry think tank that meets three times annually to discuss hotel finance, development and operations issues. Its 70 members include consultants, lenders, operators, developers, educators and legal professionals.

Co-chairmen for LIIC are Mike Cahill of Denver-based Hospitality Real Estate Counselors and Sean Hennessey of PricewaterhouseCoopers' New York office. Vice chairman is Jim Butler of Jeffer, Mangels, Butler & Marmaro, a Los Angeles-based law firm.