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CPLR 6312(b)'s Bond Requirement: Shield for Hotel Owners?



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Though hotel management agreements (HMAs) are generally long-term agreements with terms extending for decades, courts in New York and elsewhere have recently confirmed that a hotel owner at all times retains the power to terminate an HMA at any time and for any (or no) reason. See, e.g., *Mariott International, v. Eden Roc*, 104 A.D.3d 583 (1st Dept. 2013) (confirming that HMAs are “classic” personal services contracts that may not be enforced by injunction); *FHR TB v. TB Isle Resort*, 865 F.Supp.2d 1172 (S.D. Fla. 2011) (applying New York law and holding that, in addition to HMAs being personal services contracts, they are agency agreements which may be unilaterally terminated at any time by the hotel owner as principal).

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While a decision to terminate an HMA carries obvious legal implications, including triggering a possible wrongful termination claim by the hotel operator, owners increasingly are using this termination option to rid themselves of a poorly performing operator and to unlock value

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on an underperforming hotel. In response to these court decisions, operators have sought to include “contractual injunction” provisions in HMAs, entitling them by contract to what is otherwise unavailable at common law. The enforceability of such provisions remains an open question for a number of reasons,

including that attempts to limit by contract the right of a party to walk away from a personal services contract may run afoul, ultimately, of the U.S. Constitution’s Thirteenth Amendment’s proscription against involuntary servitude.

Aside from questions regarding the enforceability of such an injunction provision, an independent issue arises concerning the appropriate quantum of injunction bond that, pursuant to CPLR 6312(b), a hotel operator should be directed to post in order to secure an injunction depriving a hotel owner of its power to terminate an HMA. This article explores this issue, including whether the undertaking requirement is a potential additional barrier to hotel operators effectively enforcing “contractual injunction” provisions in HMAs.

Injunction Bond Basics

Pursuant to CPLR 6312(b), “if it is finally determined” upon a motion

to vacate the injunction or a trial on the merits that the plaintiff was not entitled to an injunction, plaintiff “will pay to the defendant all damages and costs which may be sustained by reason of the injunction.” CPLR 6312(b); *J.A. Preston v. Fabrication Enters.*, 68 N.Y.2d 397, 404-05 (1986) (“[T]he determination of the merits upon trial of the action may, indeed, establish whether a plaintiff was entitled to an injunction within the meaning of the bond.”).

The basic function of CPLR 6312(b) is to ensure that a remedy is available to a defendant who has suffered damages as the result of an improperly issued injunction. *J.A. Preston*, supra at 405. For that reason, the posting of an undertaking is not optional; it is error for a court to grant a preliminary injunction without requiring the posting of an undertaking. See *Schwartz v. Gruber*, 261 A.D.2d 526, 527 (2d Dept. 1999) (holding that “the language of CPLR 6312 (b) is ‘clear and unequivocal,’ and it requires the party seeking the injunction to give an undertaking”).

As to the appropriate quantum of an undertaking, CPLR 6312(b) directs the court to fix an undertaking in an amount that will compensate the defendant for damages incurred by reason of the injunction in the event it is determined that the plaintiff was not entitled to the injunction. *Margolies v.*

Encounter, 42 N.Y.2d 475, 478 n.1 (1977) (citing CPLR 6312(b)). It is to be fixed in an amount “reflect[ing] those actual damages defendant may incur if the court determines that the preliminary injunction was erroneously granted.” *Margolies*, supra at 479.

As a general rule, “the amount of the undertaking must be rationally related to the amount of the defendant’s potential liability if the preliminary injunction later proves to be unwarranted, and not based upon speculation.” *Lelekakis v. Kamamis*, 303 A.D.2d 380, 380-81 (2d Dept. 2003) (citations omitted); *Ithilien Realty. v. 180 Ludlow Dev.*, 80 A.D.3d 455, 455 (1st Dept. 2011). Conclusory allegations and unsupported testimony concerning potential financial losses are not sufficient justification for setting the amount of the undertaking. See *7th Sense v. Liu*, 220 A.D.2d 215, 217 (1st Dept. 1995).

Applying this standard, the most common recovery by defendants is for attorney fees incurred in a successful effort to vacate a wrongfully issued preliminary injunction. *Republic of Croatia v. Tr. of Marquess of Northampton 1987 Settlement*, 232 A.D.2d 216, 216 (1st Dept. 1996). “Attorney fees on the trial of the main action [also] are recoverable when the trial was necessary in order to terminate the preliminary injunction and where...the principal

issue upon the trial involves the right to injunctive relief....” *Metro. Lofts of NY v. Metroeb Realty 1*, 46 Misc. 3d 1222(A), at *7 (Sup. Ct. Kings Cty. 2015); *Republic of Croatia*, supra. In addition, other particular items held by courts to be within the scope of the undertaking have included “interest, court costs,... damage to the defendant’s business, loss of rent,...wages incurred because of the injunction and the value of the lost use of the defendant’s machinery.” 13 Weinstein, Korn & Miller, *New York Civil Practice: CPLR* ¶ 6312.05[2] at 63-172, 63-173, 63-174 (2d ed.).

Critically, “[t]he extent of any liability of the plaintiff for damages for obtaining the preliminary injunction is limited to the amount of the bond.” *Metro. Lofts*, supra at *6. Since the damages a defendant may collect are limited to the amount of the undertaking, it is essential that the defendant offer proof that the amount is rationally related to defendant’s potential damages, in order for defendant to fully protect itself.

Appropriate Undertaking To Enjoin Termination of an HMA

In the case of an injunction preventing a hotel owner from terminating an underperforming hotel operator, the amount of the undertaking may be substantial. In addition to consideration of the legal fees incurred by the hotel owner

to vacate the injunction, determination of the undertaking may also take into account of damages such as reasonably certain lost profits to be incurred by the hotel owner as a consequence of being forced to suffer a poorly performing hotel operator during the pendency of the injunction.

While courts have declined to consider speculative claims related to lost profits when fixing the amount of an undertaking, *Blueberries Gourmet v. Aris Realty*, 255 A.D.2d 348, 350 (2d Dept. 1998), this does not foreclose consideration of lost profits where such losses can be calculated with reasonable certainty. *Biotronik v. Conor Medsystems*, 22 N.Y. 3d 799, 806 (2014) (lost profits are recoverable when, inter alia, “the extent of the loss is capable of proof with reasonable certainty”). Though courts have not recently assessed the recoverability of reasonably certain future lost profits damages under CPLR 6312(b), in discussing the recoverability of future lost profits damages generally, the Court of Appeals has held that:

Damages resulting from the loss of future profits are often an approximation. The law does not require that they be determined with mathematical precision. It requires only that damages be capable of measurement based upon known reliable factors without undue speculation....

Ashland Management v. Janien, 82 N.Y.2d 395, 403 (1993).

Accordingly, in fixing the undertaking required before entry of a preliminary injunction halting the termination of an HMA, a court may consider lost profits proven to be reasonably certain to be suffered by the hotel owner during the pendency of the injunction. This may include the decline in profits that the hotel will suffer while being forced to suffer the unwanted hotel operator, as opposed to an alternate hotel operator performing at a market average level.

Conclusion

Given the significant revenues generated by large hotels in urban areas such as New York City, the lost profits incurred by a hotel owner forced to continue to employ an underperforming hotel operator may easily amount to millions or even tens of millions of dollars annually. Such a sizeable undertaking may be a significant disincentive to hotel operators from pursuing injunctions against hotel owners, particularly where (i) the constitutional footing of such an injunction is in question as a matter of law; and (ii) the hotel operator’s performance is shown by the hotel owner to be substandard such that succeeding on the merits is in serious question.

Accordingly, in opposition to any application by a hotel operator to

obtain a preliminary injunction stopping the termination of an HMA, in addition to all substantive arguments concerning, inter alia, the unenforceability of such an injunction and the inability of the hotel operator to succeed on the merits, a prudent hotel owner will submit proof, including expert analysis calculating future lost profits, to support the fixing of a sizeable undertaking in the event the injunction application is granted. By seriously engaging the hotel operator on the undertaking component of its injunction application, the hotel owner may be able to erect yet another barrier—a substantial undertaking—to the hotel operator obtaining injunctive relief.