New York Law Journal
Real Estate Trends
WWW.NYLJ.COM
An ALM Publication
VOLUME 253 —NO. 009
WEDNESDAY, JANUARY 14, 2015

HOSPITALITY LITIGATION

Indemnification Provisions in Hotel Management Agreements


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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, the hotel owner turns over to the manager virtually complete control over the hotel and its assets, subject only to the owner's consent in certain instances. The manager, with varying and limited approval or consent rights from the owner, dictates the hotel's finances, including the hotel's business strategy, revenue, bank accounts, and services provided to hotel guests. And it is typically the hotel manager who is the direct employer of the hotel's various personnel, having the authority to hire and fire the hotel's employees.

In the end, even though it is the hotel owner who has invested millions of dollars into buying and developing the hotel, the owner is relegated to waiting at the end of the quarter or year for the manager to turn over the owner's share of hotel profits, that is, once the manager has factored in its own costs, expenses, and bottom-line. In the meantime, the manager may pocket millions in management and other fees regardless of the performance of the hotel or the profits realized by the owner.

The disproportionate burdens born by the owner and manager do not end there, however. In the eyes of the manager, an integral part of any hotel management agreement is the indemnification provision, through which the owner is basically forced to indemnify the manager for any claims, damages or liabilities asserted against the manager save in quite limited, egregious circumstances. Thus, even though the manager operates the hotel and directly employs its personnel, the owner will likely be the party bearing the costs of defending claims asserted by hotel guests or the hotel personnel for the manager's own wrongful conduct.

This article examines the structure of common indemnification provisions in hotel management agreements and what a hotel owner must be cognizant of before agreeing to this potentially burdensome additional financial obligation.

Structure and Enforcement

Courts in New York have held that a party is entitled to complete contractual indemnification provided that the intention to indemnify is clear from the terms of the contract itself.[1]

Most management agreements contain a provision that clearly requires the owner to indemnify the manager, many of which contain one with the following structure and substance:

> The owner shall indemnify, defend, and save harmless manager from all liability, loss, damage, cost or expense, including reasonable attorneys' fees, arising from or relating to the management, operation or maintenance of the hotel, except those liabilities caused solely by the gross negligence or willful misconduct of the manager in connection with manager's performance of its obligations under the management agreement.

Therefore, other than for liability or damage caused solely by the grossly negligent or willful misconduct of the manager, the owner will be required to indemnify and cover the manager's costs of defending against any claims by third parties or its own employees, including attorney fees. In turn, the manager is typically only required to indemnify the owner in the event of liability or damages arising solely by reason of the manager's own gross negligence or willful misconduct.

A hotel owner can attempt to limit the financial impact of the indemnification by requesting that before seeking indemnification from the owner, the manager is first required to pursue available insurance coverage. The flip-side of this request is that the manager, if it wants to agree to such a provision, will require a reciprocal obligation from the owner.

With it being a difficult task—if possible at all—for an owner to avoid including an indemnification provision in the management agreement, and with those provisions being enforced by courts in New York and elsewhere, it is of paramount importance to understand what events or circumstances are actually covered by these provisions.

Gross Negligence

The impact of these indemnification provisions on the owner turns largely

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on what conduct is deemed to constitute the manager's gross negligence or willful misconduct, both in terms of (i) the manager's personnel who can be deemed to have committed gross negligence or willful misconduct and (ii) what the law holds to be conduct that is grossly negligently or willful misconduct.

Application Limited to Certain Personnel. In most instances, the terms "gross negligence" and "willful misconduct" are defined terms in the management agreement, so that the manager can specifically limit the scope of what can constitute such conduct.

Within those definitions, many hotel management agreements provide that only actions by the manager, its affiliates, executive personnel specific to the hotel, or personnel who work at the manager's corporate office can be deemed grossly negligent or willful misconduct. Actions taken by the hotel's employees—i.e. the personnel employed by the manager who largely deal with hotel guests on a day-to-day basis—are typically excluded despite the fact that they are the very employees likely to commit acts of gross negligence against guests, vendors or other third parties.

Thus, if a hotel employee, who is hired by and is a direct employee of the manager, commits acts of gross negligence or willful misconduct, the owner will be obligated to indemnify the manager for any resulting liability or damage.

What it Means to Act with Gross Negligence or Willful Misconduct. In New York, courts define gross negligence as conduct that is more than ordinary negligence, and "evinces reckless disregard for the rights of others or 'smacks' of intentional wrongdoing."[2] A party is grossly negligent only where there is a failure "to exercise even slight care… or diligence."[3]

Similar to gross negligence, under New York law:

> Willful misconduct occurs when a person intentionally acts or fails to act knowing that (his, her) conduct will probably result in injury or damage. Willful misconduct also occurs when a person acts in so reckless a manner or fails to act in circumstances where an act is clearly required, so as to indicate disregard of the consequence of (his, her) action or inaction.[4]

A court's determination of whether the manager's conduct is grossly negligent or constitutes willful misconduct will be fact specific to each case, and suffice it to say, under the definitions of those terms, proving that the manager has acted with the intent to commit such a wrongdoing against a third party is a difficult burden for an owner to bear.

For example, the failure of the manager to provide a timely response with competent personnel to a disturbance in a hotel that results in damage to a hotel guest would likely be simple negligence,[5] while the manager's intentional disregard of or refusal to attend to that disturbance may qualify as gross negligence or willful misconduct.[6]

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As we explained in our August 2014 article concerning a manager's duty to provide adequate data security measures to protect the private electronic information of the hotel's guests,[7] the current Federal Trade Commission Act[8] and the holding in *Federal Trade Commission v. Wyndham Worldwide Corporation*[9] impose an obligation on hotel managers and owners, at the very least, not to engage in unfair data security practices that could result in the theft of guest data by hackers. As we further explained, the standard of care imposed by the FTC Act and *Wyndham* most closely resembles a negligence standard, since there is no specific guidance regarding what acts by the manager or owner constitutes "unfair acts or practices" in the data security context.

Accordingly, while it is the hotel manager who implements all security measures and protocols with respect to computer and data systems, if there is a security breach and guest information is stolen, such conduct would be considered just negligence under most, if not all, management agreements. As a result, under most indemnification clauses, an owner could be obligated to indemnify the manager for any damage or liability resulting from the breach of the management companies own data security systems.

Conclusion

The difficulty that an owner will face trying to avoid indemnifying the manager—both in terms of proving who committed the actionable wrong and proving that said wrong was so egregious and wanton as to rise to gross negligence or willful misconduct—highlights the importance of an owner fully understanding the ramifications of indemnification clauses prior to executing a management agreement. Indeed, once executed, New York courts will enforce the clear terms of the provision and the hotel manager will fight hard to make sure that any liability or claim arising from a third party by reason of manager's conduct is indemnified by the owner pursuant to the indemnification provision contained in the management agreement.

Accordingly, hotel owners must proceed with great caution when negotiating and entering into hotel management agreements containing these types of operator-friendly indemnification clauses.

1. See *Drzewinski v. Atlantic Scaffold & Ladder Co.*, 70 N.Y.2d 744, 777 (1987); *Margolin v. New York Life Ins. Co.*, 32 N.Y.2d 149, 153 (1973); *Torres v. Morse Diesel Intl.*, 14 A.D.3d 401, 403 (1st Dept. 2005)

2. *Colnaghi, USA v. Jewelers Protection Servs.*, 81 N.Y.2d 821, 823-24 (1993); *Sommer v. Federal Signal Corp.*, 79 N.Y.2d 540, 554 (1992); *Obremnski v. Image Bank*, 30 A.D.3d 1141, 1142 (1st Dept. 2006); *Duggan v. Department of Motor Vehicles*, 31 A.D.2d 108 (1st Dept. 1968)

3. *Ryan v. IM Kapco*, 88 A.D.3d 682, 683 (2d Dept. 2011)

4. Pattern Jury Instructions, 3d Ed., Vol. 1A, at PJI 2:10 and PJI 2:10A; see also *Hummel v. Vicaretti*, 152 A.D.2d 779, 783 (3d Dept. 1989); *Seminara v. Highland Lake Bible Conference,* 112 A.D.2d 630, 633 (3d Dept. 1985) ("Intentional acts of unreasonable character, performed in disregard of a known or obvious risk so great as to make it highly probable that harm will result, are considered willful conduct in the real of tort law.")

5. See generally *Consumers Distributing Co., Ltd. v. Baker Protective Serivces*, 202 A.D.2d 327 (1st Dept. 1994); *Dubovsky & Sons v. Honeywell*, 89 A.D.2d 993, 994 (2d Dept. 1982);

6. See generally *Hanover Ins. v. D&W Alarm Co.*, 164 A.D.2d 112, 115 (1st Dept. 1990); *Green v. Holmes Protection of New York,* 216 A.D.2d 178, 179 (1st Dept. 1995).

7. Todd E. Soloway, Joshua D. Bernstein, and Jared D. Newman, "Protection of Hotel Guest Data and Personal Information," (Vol. 252, No. 35, Aug. 20, 2014).

8. 15 U.S.C. §45(a).

9. 2014 U.S. Dist. LEXIS 47622 (D.N.J. April 7, 2014).