

HOSPITALITY LAW

Efforts by Agents to Disclaim Their Fiduciary Duties



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A successful hotel business almost always requires collaboration between the hotel owner and a brand which often acts as managing agent of the business on ownership's behalf. These are complex relationships, involving the oversight and operation of a sophisticated hospitality business, including the development and implementation of complex sales and marketing strategies, revenue management, financial reporting and oversight of an extensive staff of employees. Adding to the complex nature of the relationship, Operators derive the vast majority of their fees as a percentage of the top-line revenues, while ownership is focused on its net operating income; and because the hotel operator by definition usually possesses superior expertise in the day-to-day operation of and management of hotels, hotel operators routinely demand significant discretion to operate the hotel as they see fit.

The parties attempt to address these potentially conflicting dynamics in the hotel management agreement (HMA). In an effort to reassure a hotel owner who

is being asked to relinquish day-to-day operations of its valuable business to a responsible third party, among other things the parties have historically agreed that the hotel operator undertake its duties as the owner's agent, and thus owing the owner the fiduciary duties of utmost good faith, loyalty, and honesty. However, there is a trend in the hospitality industry in which operators are seeking to limit or avoid the fiduciary obligations attendant to a principal-agent relationship by either generally disclaiming the existence of a principal-agent relationship between operator and owner, or by specifically disclaiming that the operator, as agent, owes fiduciary duties to the owner.

This article explores whether this effort by hotel operators to curtail their fiduciary obligations to hotel ownership, and thereby reduce their exposure to liability for violating same, is compatible with long-settled principles of New York law governing agency relationships. Simply put: Can they do it?

Agency Basics

Fiduciary obligations frequently arise in the context of a principal-agent relationship. Under New York law, "an agency relationship results from a manifestation of consent by one person to

another that the other shall act on his behalf and subject to his control, and the consent by the other to act." *Gulf Ins. Co. v. Transatlantic Reins. Co.*, 69 AD3d 71, 96–97 (1st Dept. 2009) (citation & quotations omitted); *CBS Outdoor Inc. v. Santa's LLC*, No. 102658/07, 2008 N.Y. Misc. LEXIS 9252, at *15-16 (Sup. Ct., N.Y. Co. July 28, 2008) (citing Restatement (Third) of Agency §§1.01, 1.02 (2006)). Such agency relationships arise either expressly (i.e., when parties memorialize their agency relationship in a contract) or impliedly (i.e., when parties act in a manner that evinces that one party, the agent, is acting for the benefit and under the control of the other, the principal). See, e.g., *CBS Outdoor Inc.*, 2008 N.Y. Misc. LEXIS 9252, at *15 (finding an agency relationship created by the words of the parties' contract); *Gulf Ins. Co.*, 69 AD3d at 97 ("As a review of the 'general agency agreement' makes clear, the true relationship between [the parties]...is that of principal and agent.").

In the performance of its obligations to act on behalf of its principal, "agents...are bound to exercise the utmost good faith toward their principals." *Northeast Gen. Corp. v. Wellington Adver. Inc.*, 82 N.Y.2d 158, 164 (1993) (citation omitted); see also *Faith Assembly v. Titledge of N.Y. Abstract*, 106 AD3d 47, 61 (2d Dept. 2013) ("[A]gents

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owe their principals duties of loyalty, obedience, and reasonable care[.]”); *Amtrust N. Am., Inc. v. Safebuilt Ins. Servs., Inc.*, No. 14-CV-0494 (CM), 2015 WL 7769688, at *6 (S.D.N.Y. Dec. 1, 2015) (“It is, of course, well settled that an agent owes a fiduciary duty to its principal...to act loyally for the principal’s benefit in all matters connected with the agency relationship.” (citations omitted)). As Justice Benjamin Cardozo famously explained, fiduciaries are held to a standard “stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is...the standard of behavior.” *Meinhard v. Salmon*, 249 N.Y. 458, 463-64 (1928). “The core of a fiduciary relationship is a ‘higher level of trust than normally present in the marketplace between those involved in arm’s length business transactions.’” Faith Assembly, 106 AD3d at 62 (quoting *EBC I, Inc. v. Goldman Sachs & Co.*, 5 N.Y.3d 11, 19 (2005)).

This standard presents the operator with a host of potential liabilities, particularly when, as in the hospitality industry, the business motivations of the brand diverge from those of the owner. Hence, the efforts by the brands to disclaim such potential exposure.

Disclaiming Duties?

The relationship between a hotel owner and operator has long been considered to be one of principal and agent. See Restatement (Third) of Agency §3.10, Illustration No. 3 (2006). In an effort to minimize these fiduciary obligations, hotel operators frequently seek, by the language of the HMA, to: (i) disclaim entirely the existence of a principal-agent relationship between the hotel owner and operator; or (ii) specifically disclaim or materially narrow the scope of the fiduciary duties owed by the hotel operator to the owner. However, as recently articulated by the

Southern District in *Veleron Holding v. Stanley*, 117 F. Supp. 3d 404 (S.D.N.Y. 2015), enforcement of such disclaimers without examining the nature of the parties’ relationship would offend long-settled principles of New York law.

Consistent with the established maxim that a fiduciary relationship exists where a party is under a duty to acting on behalf of another, New York law clearly recognizes that “where a [contract] erects the essential structure of an agency relationship, even an explicit disclaimer cannot undo it.” 117 F. Supp. at 452 (citing *EBC I, Inc.*, 5 N.Y.3d at 20). In other words, in New York it is a fundamental tenet of agency law that an agency

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is still an agency regardless of how it is characterized by the parties. See, e.g., *CBS Outdoor Inc.*, 2008 N.Y. Misc. LEXIS 9252, at *15–16; Restatement (Third) of Agency §1.02. In addition, because an agent inherently owes fiduciary duties to its principal as a function of its agency, whether created by contract or by the true nature of their relationship, New York law prohibits a party from undermining those essential duties, “even [by an] explicit disclaimer.” *Veleron Holding v. Stanley*, 117 F. Supp. 3d at 452.

In *Veleron*, Morgan Stanley agreed to act as BNP’s “agent” in respect of the disposal of all or part of certain assets. See *id.* The agreement, however, purported to specifically disclaim that Morgan Stanley was acting as a fiduciary:

[I]n providing investment banking services to the client in connection with any Disposal or the Disposal Programme, [Morgan Stanley] is acting as an independent contractor and not as a fiduciary, and BNP does not intend Morgan Stanley to act in any capacity other than independent contractor including as a fiduciary or in any other position of higher trust.

Id. at 415. Despite this explicit disclaimer, the court found that if “the essential structure” of an agency relationship was created by the parties’ agreement, an agency existed and Morgan Stanley could not avoid complying with its attendant fiduciary duties. *Id.* Thus, when a contract creates the “essential structure” an agency relationship, the agent may not escape its duties of loyalty, good faith, and honesty to the principal.

Conclusion

While hotel operators continue to seek avenues to limit their obligations to hotel owners, efforts to escape the heightened duties owed by an agent are inconsistent with the long-standing principles of New York law barring parties from disclaiming the existence of an agency relationship (as well as the attendant fiduciary obligations). Nonetheless, hotel owners would be wise to remain vigilant and resist efforts by managers to disclaim these essential obligations.