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Here's Looking at You, Starwood: A Piercing the Corporate Veil Story?

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An international drama is playing out in courtrooms across the world, with the most recent setting the United States District Court in Delaware. In addition to the captivating cast of characters—including titans of the financial and hospitality worlds—and exotic subject matter—the stewardship of a historic hotel in Casablanca, Morocco—this still-unfolding tale is, according to some, poised to potentially recast the rules of alter ego and agency liability in ways that could significantly impact the hospitality industry and beyond.

In this article, we discuss and analyze this decade-old dispute and consider steps hospitality industry stakeholders can take to protect against unforeseen liability due to the actions of corporate affiliates.

Setting the Scene

Compagnie des Grands Hotels d'Afrique S.A. is the owner of the Royal Mansour Hotel in Casablanca. The Royal Mansour, named in honor of a significant figure in Moroccan history, opened over 70 years ago as one of the first modern luxury hotels in Morocco and the only international five-star hotel in Casablanca.

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In 1989, Compagnie entered into a long-term management agreement with an international hotel group (Trusthouse Forte Group) by which Trusthouse agreed, among other things, to pay a minimum monthly fee to Compagnie and to operate and maintain the hotel at luxury standards.

By 2005, the Meridien Group had acquired the rights of Trusthouse under the management agreement. A joint venture between Lehman Brothers and Starwood Capital, called Starman, purchased the brand and management business of the Meridien Group, renaming the Royal

Mansour's manager Woodman Maroc.

As part of the deal, Woodman signed an operating agreement with Starwood Hotels & Resorts Worldwide, Inc., by which Woodman delegated management and operating authority to Starwood Hotels as its agent. At the time, Starwood Capital and Starwood Hotels shared the same Chairman and CEO.

Well before Starman's involvement, the Royal Mansour was struggling, with the manager not making enough money to cover its costs. Thereafter, the hotel continued to struggle and allegedly fell into disrepair, with Woodman needing funding from Starman to meet its obligations including its monthly fee due to Compagnie.

When the global financial crisis hit, Lehman Brothers collapsed, and Starman stopped funding Woodman's payment obligations to Compagnie (even while continuing, for a time, to fund payments to Starwood Hotels). Woodman filed for insolvency in the Commercial Court of Casablanca, but its filing was dismissed.

In August 2013, Compagnie started an ICC arbitration against Woodman in England. During the arbitration, Starman sold Woodman to an affiliate, and the new owner put Woodman's new parent into insolvency proceedings in England. Woodman stopped participating in the arbitration, and in 2015, Compagnie obtained a default judgment against Woodman for over $55 million plus interest, which was never satisfied.

The Action Moves to Delaware

In April 2018, Compagnie commenced a federal action in the District of Delaware against Starman and Starwood Capital—Woodman's corporate parent and grandparent, respectively, at the time of the alleged breaches—under the New York Arbitration Convention permitting American courts to enforce foreign arbitral awards.

Compagnie seeks to pierce the corporate veil by alleging Starman (as Woodman's parent) is Woodman's alter ego and agent, and Starwood Capital (as Starman's parent) is also liable because Starman is Starwood Capital's agent, and thus, if Starman is liable, so should be Starwood Capital.

Under Delaware law, a company may pierce the corporate veil if it is able to prove that the two companies: (1) acted as a single entity and (2) the subsidiary company misused the corporate form in order to cause fraud or injustice. See *Manichaean Cap., LLC v. Exela Techs., Inc.*, 251 A.3d at 706-707 (Del. Ch. 2021); *Wallace ex rel. Cencom Cable Income Partners II, L.P. v. Wood*, 752 A.2d 1175 (Del. Ch. 1999).

Starman and Starwood Capital initially moved to dismiss the agency claims. Third Circuit Judge Stephanos Bibas, sitting by designation, dismissed Compagnie's agency claims with prejudice. The District Court reasoned that a parent may be liable for its subsidiary's breach of contract only "if the parent existed at the time the subsidiary signed the contract." Since the management agreement with Compagnie came to be "decades before [Starman] was formed," Starman could not be liable for Woodman's actions.

In September 2022, both sides moved for summary judgment on the sole remaining alter ego claim. Judge Bibas once again ruled in favor of Defendants, holding that Compagnie failed to establish entitlement to "the extraordinary remedy of piercing the corporate veil," stating "Woodman breached its contract with Compagnie and went broke. These are the ordinary risks of doing business, and there are ordinary ways to address them…. But ordinary business problems do not justify the extraordinary remedy of piercing the corporate veil."

A Plot Twist

Compagnie appealed the District Court's judgment. In September 2024, the U.S. Court of Appeals for the Third Circuit reversed the District

Court's order and remanded Compagnie's claims back to the District Court for further proceedings—including Compagnie's agency claims that had previously been dismissed, with prejudice. *Compagnie des Grands Hotels d'Afrique S.A. v. Starwood Capital Group Global I, LLC*, No. 23-2631, 2024 WL 4249723 (D. Del. September 20, 2024).

On the agency claims, the Third Circuit disagreed with the District Court's reasoning, holding "[w]hen the cause of action is breach of contract, the relevant inquiry is not whether the corporate parent existed when the contract was formed, but whether it existed when the contract was breached." *Id.* at *2.

As to Compagnie's alter ego claim, the Third Circuit found a genuine dispute of fact as to whether Starman made Woodman siphon funds upstream after it became insolvent—by continuing to make payments to Starwood Hotels to protect another Starman affiliate—warranting veil piercing.

While the District Court had rejected Compagnie's siphoning argument, holding Starman "did not siphon money from Woodman; it funded Woodman," the Third Circuit disagreed, stating "[w]hat matters is 'not what [Starman] put in the company, but when they took it out.'" *Id.* at *5.

Starwood and Starman petitioned for rehearing by the panel and the Third Circuit *en banc*. Addressing the Third Circuit's alter ego holding, they argued the decision "marks an abrupt shift in the limited-liability regime that has long reigned" in Delaware.

They further argued the decision "significantly expands the circumstances in which a parent may be liable for a subsidiary's wrongdoing," a particularly troubling outcome given "the outsized significance of Delaware law to parties and courts around the country (and world) is self-evident."

Regarding the agency holding, they argued that it "will unquestionably lead to a flood of litigation seeking to hold parents liable in contract for breaches arising from agreements entered into well before those parents existed, further breaking down the corporate separateness that has been a hallmark of Delaware law and this Court's jurisprudence."

Despite this professed parade of horribles, on Nov. 13, 2024, the Third Circuit denied Starman's petition and the case is now proceeding in the District Court.

The Takeaway

While the Third Circuit made clear that, in reversing, it was not determining that veil-piercing was appropriate, its holding is nonetheless cautionary. With the hospitality industry continuing to experience significant M&A activity, it is critical that industry participants perform diligence to assess all potential liabilities that may be lurking.

And, after the acquisition is completed, new owners need to be highly strategic and deliberate in working through difficult assets, at all times thoroughly considering the risks of intentionally breaching contractual obligations. While corporate separateness remains a foundational concept in the law, it is not and never was a panacea. As always, an ounce of prevention is worth a pound of cure.

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