

CHAPTER 5

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“YOU REALLY SHOULD look into buying them,” said Latisha Austin. “Our guests absolutely love them!”

The “them” Latisha was referring to were the mattresses and box springs that made up the new line of Peaceful Sleep bedding Latisha had just purchased for her 117-room limited-service hotel.

It was a beautiful, sunny Thursday afternoon, and Trisha Sangus and Latisha had decided to meet at the Walnut Hills Country Club to play a round of golf and talk “shop.” Trisha loved to play golf and so did Latisha. Trisha also enjoyed Latisha’s company and their conversations.

As they chatted at the first tee, awaiting their tee time, Latisha was telling Trisha about the new line of

mattresses that had recently been made part of the upgraded bedding standard for all Sleep Well hotels.

Latisha was the general manager of the Sleep Well property in the same town that Trisha's hotel was located. Mr. Larsoon, a real estate developer who had limited hotel experience but possessed excellent business sense, owned it. Trisha knew Mr. Larsoon well because, earlier in her career, she had worked for a time as the front office manager of the Sleep Well. Mr. Larsoon was an honest businessperson and had taught Trisha much before he retired.

"Of course, they were expensive," continued Latisha, "but we really have had lots of good comments on them."

"Are those the Perfect Sleep mattresses I read about last week in *Hotel Monthly*?" asked Trisha.

"No—mine are Peaceful Sleep," replied Latisha, "Perfect Sleep are the ones advertised by the Town Park Hotels. My franchise service manager says our mattresses are better."

"How did you choose the supplier of the ones you bought?" asked Trisha.

"That's the best part," replied Latisha, "Select Hotels—our franchisor—set it up so we had our own line of mattresses made by Thompson Mattresses. They designed them just for us. So I just bought the beds from them."

"Thompson also makes the Perfect Sleep," said Trisha. "How did Sleep Well pick that vendor?"

"I don't really know," replied Latisha. "I just got an e-mail announcing the bedding upgrade, then another announcing that we could buy direct from the factory."

"What were the actual mattresses specs?" asked Trisha. "Did you try to buy them locally?"

"We didn't get specs, just the brand name of the mattresses—that made it really easy, so I didn't look

for a local manufacturer. Besides, with the whole company buying the beds direct, I'm sure we all got a better price for them than I could have gotten locally."

"How many Sleep Wells are there?" asked Trisha.

"I think there are a little over 2,000," replied Latisha.

"Just out of curiosity," Trisha asked, "what do you think would have happened if you had bought alternative mattresses? I mean, ones of the same or better quality than the ones you did buy, but from a different manufacturer?"

"Oh, we couldn't have done that," replied Latisha. "If we didn't meet the brand standards, we'd lose points on our biannual Inspection Quality score. You must remember that!"

Trisha remembered well how excited and nervous everyone at Latisha's hotel got when the Sleep Well "inspector" made the twice-yearly property visit. The actual score the hotel received on its inspection was always very important to the general manager and reflected a variety of factors, one of which was that individual property's adherence to the franchisor's ever-changing brand standards.

"Well," said Latisha, as she approached the white tees and readied her ball, "You really should look into them. You really can't go wrong in this business when you're trying to give your guests as comfortable a night's sleep as possible."

"*Perfect Sleep or Peaceful Sleep, the Thompson Company certainly created clever names and clever marketing programs,*" thought Trisha. Trisha actually had no doubt that the new beds Latisha had purchased were, in fact, comfortable. She also had no doubt, however, that if she were managing the Sleep Well, she would have been uncomfortable recommending their purchase to Mr. Larsoon.

IN THIS CHAPTER, YOU WILL LEARN:

1. Contract clauses commonly utilized in hospitality contracts.
2. The purpose of a franchise contract (franchise agreement).
3. The purpose of a management contract (management operating agreement).
4. Important forms of meeting space contracts used in lodging operations.
5. Important forms of group rooms contracts used in lodging operations.

5.1 SPECIFIC CONTRACT CLAUSES

In the previous chapter, you learned about basic business contracts. Many of the contracts used in the hospitality and tourism industries are very similar to those used in other industries; these include contracts regarding employment, routine facilities and grounds maintenance, equipment purchases, employee insurance, and accounting services, to name but a few areas. There are, however, some unique and very specialized hospitality- and tourism-related contracts and contract terminology you will likely encounter during your hospitality career. In this chapter, you will learn about this industry-specific terminology, as well as some types of specialized contracts.

Types of Specialized Contracts

Although it is not possible to list all of the potential types of specialized contracts hospitality managers may confront, the following four types deserve special explanation because of their widespread use in the hospitality industry. Each of these contract/agreement types is examined in detail later in this chapter.

Franchise-related Contracts

As you learned in Chapter 3, in a franchise arrangement, the owner of a hospitality facility, (the franchisee) agrees, in exchange for a franchise, to operate the business in a specific manner approved by the franchisor. The actual franchise contracts utilized in the selection, purchase, and implementation of franchise operating agreements are highly regulated and very detailed. Unless very carefully created and thoroughly read, these intricate agreements can often be misconstrued or misinterpreted by the contracting parties. Therefore, it is important to fully understand their intent and complexity.

Management Operating Agreements

A management contract, or as it is very commonly known, a management *operating agreement*, is created when the owner of a hospitality facility allows another party to assume the day-to-day operation of that facility.

Hospitals, school foodservices, campus dining operations, and business dining facilities are commonly operated under management contracts. Hotels, from the smallest to the largest, can also be operated in this manner. In an operating agreement (management contract) the facility owner allows the management company to make the operational decisions that are necessary for the facility to effectively serve its clientele. Typically, a management contract will set forth, in great detail, the period that the agreement will be in effect, the payment terms, the responsibilities of each party, and the stipulations by which the arrangement can be ended, as well as a variety of legal and operational issues. These agreements are typically very detailed and, as a result, understanding their basic components as well as areas of possible contention is very important.

Meeting Space Contracts

Although many limited-service hotel's guestroom contracts consist only of individual or group rooms sales agreements, full-service hotels will enter into many meeting space contracts in addition to their individual and group room contracts. Especially in larger hotels with significant amounts of meeting, event, and convention space, not only are meeting space contracts common, but also their proper management is essential to the profitability of their respective properties.

Hotels are not the only segment within the hospitality industry that utilizes meeting and space contracts. Convention centers, country clubs, restaurants, and catering halls are just a few of the many hospitality industry facilities that routinely rent space and may provide meetings related services to their guests. Such facilities must carefully detail, via a contract, the services they will provide their guests, as well as the terms under which they will provide them.

In many cases, the contract terms for meetings are negotiated between a hotel and one or more professional *meeting planners*.

Meeting planners annually buy large numbers of sleeping rooms, as well as reserve significant amounts of meeting and catering space. Meeting planners may negotiate group room contracts, meeting space contracts, or both combined into one contract. These individuals may represent a variety of corporations, groups, and organizations. They are sophisticated buyers of hotel products who often use comparison-shopping

LEGALESE

Operating agreement:

A contract that details the areas of responsibilities of the owner of a business and the entity selected by the owner to operate the business. Also referred to as a "management contract."

LEGALESE

Meeting planners: A group of professionals that plan and organize meetings and events for their employers and clients.

techniques, and who can heavily influence a hotel's reputation based on their experience with it. It is not unusual for hotels to designate one (or more) very experienced staff members to deal exclusively with this group of professionals. As a result, understanding how these contracts are actually negotiated and developed is essential to hospitality managers in a variety of industry segments.

Search the Web 5.1

Meeting Professionals International (MPI) is the world's largest association of meeting planning professionals, with over 20,000 members. You can learn more about this group by visiting its website at www.mpiweb.org.

Note the large number of educational services it offers. Many of these are designed to help the members better negotiate and administer the meetings contracts they execute with the hotels they select for their meetings.

Group Lodging Contracts

A group rooms contract is developed when an individual or organization requires a large number of hotel rooms. Nearly all hotels rely, to some degree, on group business to help maximize their room sales revenue. The situations in which group rooms are sold can be as varied as an agreement with an airline to provide overnight accommodations for flight crews, to group meetings and conventions, and family weddings. In Chapter 4, "Business Contracts," you learned that hotels are required to honor individual guestroom reservations because when such reservations are made, they constitute valid business contracts. As well, when group reservations are made, a unique type of contract is created, and hotels must also honor these.

Group room contracts are different, in many ways, from individual room contracts, and they frequently contain distinctive features that must be well understood by hoteliers. Group room contracts are common because many hotels require that any room request exceeding a total of 10 sleeping rooms per night be confirmed by a written contract. The reason is simple: When a guest requests a large number of rooms, he or she may expect a discount for each room purchased. This is often agreeable to the hotel, but the precise conditions under which the discount is to be offered are best confirmed with a written contract. Furthermore, a group rooms contract may be drawn up months or years before the rooms will actually be used. This is often the case for large convention hotels that may contract for rooms and space several years ahead of time. A written contract guarantees that the sponsoring group will have the amount of rooms they need and the hotel can expect to receive revenue for the use of its rooms for a certain period of time. In this chapter, you will learn how group lodging contracts should be structured.

In addition to the unique types of contracts that are found in the hospitality industry, there are also industry-specific words and phrases that must be understood if contracts of these special types are to be properly created and their terms accurately followed. These special types of contract wording are known as essential *clauses*.

In the next portion of this chapter, you will examine essential contract clauses that hospitality managers should carefully examine in all of the contracts they execute; as well as those provisions utilized in the contracts they negotiate when they

LEGALESE

Clause (contract): A distinct contract provision or stipulation.

sell products and services to their customers and guests, and the essential clauses they utilize when they contract to purchase their own business-related products and services. When you understand all of these, you will be ready to learn more about specialized hospitality and tourism contracts.

Since business contracts can cover a variety of offer and acceptance situations, their form and structure can vary considerably. That said, all hospitality contracts should contain certain essential clauses, or stipulations, that a manager should identify and review carefully before entering into the contract relationship. These essential clauses are actually not specific wordings; rather, they are areas or terms of the agreement that should be clearly spelled out, to ensure that both parties to the contract understand them completely. The reason for including these clauses in contracts, and for reviewing them carefully, is to prevent ambiguity and misunderstanding.

Essential Clauses for Providing Products and Services to Guests

It is always better to settle potential difficulties before agreeing to a contract than to be forced to resolve them later, and perhaps create ill will or significant legal problems. Reviewing the following essential clause areas in contracts, before agreeing to their terms, can help you do just that.

Length of Time the Contract Price Terms Exist

When an offer is made, it generally will include the price proposed by the seller. It is just as important to clearly establish exactly how long that price is to be in effect. When issuing coupons, for example, the manager of a quick-service restaurant (QSR) will want to clearly inform consumers of the coupon's expiration date. If a hotel's director of sales grants a particular corporation a special discounted room rate based on anticipated rooms sales, it is important to note the length of time that the reduced rate will be in effect. When any offer for products or services includes a price, the wise hospitality manager will specify the time frame for holding, or honoring, that price.

Identification of Who Is Authorized to Modify the Contract

Unanticipated circumstances can cause guests to change their plans at the last minute. This is especially true in lodging, where group rooms or meeting contracts may be modified during the group's stay. A typical situation would be one in which an organization signs a contract for meeting space. In one of the meeting rooms, an invited speaker requests that a liquid crystal display (LCD) projector and projection screen (items not included in the original contract) be provided for his use. If, acting on the request of the speaker, the hotel provides the equipment, the contracting organization may later refuse to pay for it. Although the equipment was in fact provided, the invited speaker was not authorized to modify the original contract.

It is always important to identify, prior to agreeing to contract terms, exactly who will be given authority to modify the contract should the need arise. It is also best to require that any modifications to the contract be in writing wherever practical.

Deposit and Cancellation Policies

Hotels often require deposits before they will reserve sleeping rooms for guests. It is important to remember that hotel rooms are an extremely perishable commodity. Room nights cannot be "saved up" by hotel managers in anticipation of heavy demand, nor can their numbers be quickly increased in the face of heightened actual

Cancellation Clause

If arrangements for the event are canceled in full, a fee consisting of a percentage of the total anticipated revenue outlined in this contract will be charged. The fee is determined by the length of time between written notification of the cancellation and the scheduled arrival date as follows:

0–31 days prior to arrival	100% of anticipated revenue
32–90 days prior to arrival	75% of anticipated revenue
91–180 days prior to arrival	50% of anticipated revenue
181–365 days prior to arrival	25% of anticipated revenue

Anticipated revenue may include room, meal, gratuities, telephone, and hotel-provided services, as well as taxes due on recovered sums.

Figure 5.1 Cancellation clause.

demand. Consequently, hotel managers must be very careful to ensure that rooms reserved by a guest will in fact be purchased by the guest. The portion of a contract that details an operation's deposit and cancellation policies is critical both to the hotel and to the guest, and thus must be made very clear.

Deposits guarantee reservations. Typically, a deposit equal to the first night's room and tax bill will be required on group lodging contracts and some individual room reservations. This deposit may be required at the time of the contract's signing or 30 days prior to the group's arrival. For most individual room reservations, a credit or debit card number from a valid payment card is the method used to guarantee the reservation. In other cases, personal checks or certified checks may be required.

Cancellations of reservations can occur for a variety of reasons. If the hotel is to have a fair cancellation policy, it must consider the best interests of both the hotel and the guest, and the policy must be clearly stated in the contract. This is true whether the contract is oral or written. Generally, failure to cancel a guaranteed reservation by the agreed-on time will result in forfeiture of an advanced deposit or one night's room and tax, billed to the payment card number that was given to guarantee the reservation.

When groups are very large and the revenue expected from the group's stay at the hotel is substantial, cancellation penalties can be more tightly defined. Figure 5.1 illustrates the type of clause used in a convention hotel to protect the hotel from last-minute cancellations of an entire group.

Allowable Attrition

Allowable *attrition* refers to the amount of downward variance that may be permitted in a contract before some type of penalty is incurred on the part of the guest.

Attrition, then, is simply the loss of previously estimated guest counts. Consider, for example, the individual guest responsible for hosting a large family reunion in his or her city. When the guest first approaches the hotel to reserve sleeping rooms and space for meals, the family reunion might be months away. The guest will want to know the specifics of room rates to be charged, as well as prices for meals. Both of these charges, however, might depend on the "pick-up," or actual number of served guests. This is true because, in most cases, the larger the number of sleeping rooms sold or meals provided, the lower the price. At the time of the contract signing, however, the actual number of guests to be served is likely unknown. The guest responsible for planning the reunion may estimate 200 attendees when planning the event, but at the reunion, only 100 individuals attend. Allowable attrition clauses inform both parties of the impact, on price, of a reduced number of actual guests served.

LEGALESE

Attrition: Reduction in the number of projected participants or attendees.

Allowable Attrition Clause

The Hotel agrees to hold ample inventory to accommodate the rooms reserved in this Group Rooms Contract. In doing so, the Hotel may be put in a position to turn away other groups that may request rooms for the same dates. Therefore, the Hotel limits the amount of attrition or reductions in the contracted room block. Additional reductions will be billed at 100% of the contracted room and tax.

91 days or more prior to arrival	50% of room block
61–90 days or more prior to arrival	20% of room block
31–60 days or more prior to arrival	10% of room block
Less than 31 days prior to arrival	2% of room block

For all meal and meeting functions, the Hotel reserves the right to move groups to a room with capacity equal to the actual number of guests to be served.

Figure 5.2 Allowable attrition clause.

Figure 5.2 is an example of an allowable attrition clause in a group lodging contract. Notice that both parties to the contract are clearly informed about the consequences of reduced pick-up on the part of the guests. In addition, the clause has a statement clearly indicating that if the size of the group is reduced by too much, the hotel may relocate the meal or meeting space of the group. This is particularly important in a facility with restricted meeting space, where there might be only one large ballroom. If guests reserve this room based on a large estimate, which then fails to materialize, the hospitality manager might have no choice but to move the group to a smaller room, thus freeing the larger room for potential resale.

It is important to remember that guests often overestimate the projected attendance at their functions. If hospitality managers do not consider the impact of attrition, their operations may be hurt by this common guest tendency. As attrition disputes are becoming more common, meeting planners are insisting that contracts also include clauses that hold the hotel accountable for using diligence to resell any rooms unused by the meeting to reduce the damages caused by exceeding the allowable attrition.

Indemnification for Damages

To indemnify means to secure against loss or damage. Indemnity language is important when a hotel contracts with an organization whose individual members will occupy rooms designated under a group contract. In one situation, an organization of law enforcement officers contracted with a hotel to hold its annual convention. During the course of the convention, a few members of the organization became intoxicated and caused some damage to the physical property of the hotel. The question then arose: Who should be held responsible for the damages? The law enforcement organization, the individual officers, and the cities that employed them were all considered possible sources of damage reimbursement.

It is important to make clear exactly who will be responsible if damages to rooms or space should occur. Although significant damage during a guest's stay is certainly the exception rather than the rule, the possibility of consequential damage does exist and should be addressed. A general clause covering this area in a group rooms contract might read as follows:

The group shall be liable for any damage to the hotel caused by any of its officers, agents, contractors, or guests.

Payment Terms

Although payments and terms for payment might seem relatively straightforward, in the hospitality industry, contract payment terms can sometimes become quite complex. Consider the case of a visiting college basketball team. The head coach reserves sleeping rooms and agrees to pay for the rooms with a college-issued credit card. One of the players, however, makes several hundred dollars' worth of long-distance telephone calls from his hotel room. Who is responsible for this payment? Further, how can the hotel hope to collect the monies due to it? The best way to address problems such as these is to clearly and precisely state the terms of payment and the responsibility for all expenses incurred.

Dining establishments generally require a cash, check, or credit/debit card payment at the time of meal service. In the lodging industry, payment can take a variety of forms:

- Individual guest pays all charges.
- Company or group pays all charges.
- Payment in full is required prior to arrival.
- Hotel directly bills the company or group for room and tax only.
- Hotel directly bills the company or group for all charges.
- Individual guest pays incidentals (e.g., telephone, meals, movies, laundry, and parking).
- Multiple guests are all billed to one common master bill.

Note that in the preceding example, if the coach's contract called for the group to pay all charges, then the college would indeed be responsible for the long-distance telephone charges. If the contract included a clause in which individuals pay for incidentals, then the individual player would be held responsible for the charges. The importance of using precise language to prevent ambiguity should be apparent.

Performance Standards Related to Quantity

Previously, we discussed ways for hospitality managers to address the problem of attrition and no-shows. But what of the guest whose actual numbers exceed the original estimate? If, for example, a catering hall anticipates serving 200 guests, but 225 people arrive to attend the event, the operation may face space and production shortages. Because this type of situation is also common, many operators will prepare food and create place settings in the dining room for a number of guests larger than the contracted guest count. This approach prevents frantic, last-minute attempts to meet an unanticipated demand.

While there is no industry standard established, many operators find that agreeing to prepare for 5 percent more guests than the contracted number is a good way to balance the potential needs of the guest with the actual needs of the operation. When the operation agrees to a performance standard related to quantity, this standard should be clearly stated in the contract.

When providing for products and services in the vastly diverse hospitality industry, additional essential clauses may be required based on the type and style of the hospitality facility. When that is the case, management should identify these potential problem areas and address them each and every time a contract is executed.

Essential Clauses for Purchasing Products and Services

Just as there are essential and important components of a contract that state when the hospitality manager is responsible for providing products and services, it is equally critical to ensure that essential clauses are in place when hospitality managers

contract to purchase or receive products and services. Here, too, it is in the best interest of both parties to get all contractual arrangements in writing. Listed next are some of the important contractual elements to be considered before executing a purchasing contract.

Payment Terms

Some of the most significant components of a contract for buying products and services are the payment terms. Consider the case of the restaurateur who wants to purchase a new roof for her restaurant. She gets three bids from contractors, each of whom quotes her a similar price. In one case, however, the builder wants full payment prior to beginning work. In the second case, the builder wants half the purchase price prior to beginning the job and the balance upon a “substantial completion” of the work. In the third case, payment in full is required within 30 days after completion of the job. Obviously, in this case, the payment terms could make a considerable difference in which contractor gets the bid.

Required down payments, interest rates on remaining balances, payment due dates, and penalties for late payments are points that should be specified in the contract, and reviewed carefully.

Delivery or Start Date

In the case of some delivery dates, a range of times may be acceptable. Thus, when purchasing sofas, a hotel could insert contract language, such as “within 60 days of contract signing” as an acceptable delivery date clause. In a like manner, food deliveries might be accepted by a kitchen “between the hours of 8:00 A.M. and 4:00 P.M.”

In some cases, the delivery or start date may be unknown. Consider, for example, the following contract clause written when a hotel agreed to lease part of its lobby space to a flower shop. The time it would take to get the shop stocked and operational was unknown, and thus the start date of the lease could not easily be determined. The delivery/start clause here is part of that longer contract document. In the section titled “Start Date,” it reads:

The initial Operating Term of this agreement shall commence at 12:01 A.M. on the first day the Flower Shop is open for business and terminate at 11:59 P.M. on the day preceding the tenth (10th) anniversary thereof; provided, however, that the parties hereto may extend this agreement by mutual consent for up to two (2) terms of five (5) years each.

Note that, though the actual start date was uncertain, the language identifying precisely when the start date was to occur was unmistakable. In all cases, it is important that a start date be present and that it be clear.

Completion Date

Completion dates let the contracting parties know when the contract terms end. In the case of a painter hired to paint a room, this date simply identifies when the painter’s work will be finished. If the contract is written to guarantee a price for a product purchased by a restaurant, the completion date is the last day that price will be honored by the vendor.

It is often difficult to estimate completion dates. This is especially true for construction contracts when weather, labor difficulties, or material delays can affect timetables. Despite these difficulties, completion dates should be included whenever products or services are secured.

Some contracts are written in such a manner that the completion or stop date of the contract is extended indefinitely unless specifically discontinued. The following

clause is taken from an agreement to cooperatively market hotel rooms with a discount hotel broker. Note the language related to the contract's extension:

Unless otherwise noted in the contract, this participation agreement between the hotel and Tandy Discount Brokerage automatically renews on an annual basis unless cancellation is received in accordance with established publication period deadlines.

Self-renewing contracts are common, but must be reviewed very carefully by management prior to acceptance of their terms. It is important to calendar (identify for future attention) any action required by management to discontinue a self-renewing contract so that critical dates will not be missed.

Performance Standards

Performance standards refer to the quality of products or services received. This can be an exceptionally complex area because some services are difficult to quantify. The thickness of concrete, the quality of carpeting, and the brand or model of a piece of equipment can, for example, be specified. The quality of an advertising campaign, a training program, or interior design work can be more difficult to evaluate.

The effective hospitality manager should quantify performance standards in a contract to the greatest degree possible. With some thought, and help from experts in the topic the contract is about, great specificity may be determined. Consider the foodservice manager who wishes to purchase canned peach halves. A purchase specification, such as the following, could be included as part of the purchase contract:

Peaches, yellow cling halves, canned. U.S. Grade 3, (Choice), packed 6, number 10 cans per case, with 30 to 35 halves per can. Packed in heavy syrup, with 19 to 24 Brix; minimum drained weight, 66 ounces per number 10 can, with certificate of grade required.

Recall that under the Uniform Commercial Code (UCC), a vendor is contractually obligated to provide goods that are fit for use and free of defects. Clauses that specify performance standards in a purchasing contract give both buyers and sellers an added level of protection, because the extra details will clearly spell out the expectations of both parties, with regard to the nature and quality of the goods transferred.

Licenses and Permits

Obtaining licenses and permits, which are normally required for contracted work, should be the specific responsibility of the outside contracting party. Tradespeople, such as plumbers, security guards, air conditioning specialists, and the like, who must be licensed or certified by state or local governments, should be prepared to prove they indeed have the appropriate credentials. However, it is the responsibility of the hospitality manager to verify the existence of these licenses, if they are required to perform the terms of a contract. In addition, a photocopy of these documents should always be attached to the contract itself. Figure 5.3 is an example of a general clause related to the issue of licenses and permits.

Indemnification

Accidents can happen while an agreement is being fulfilled. In order to protect themselves and their organizations, hospitality managers should insist that the contracts they execute contain *indemnification* language similar to this example:

Contractor hereby agrees to indemnify, defend, and hold harmless the restaurant and its officers, directors, partners, employees, and guests from and against any losses, liabilities, claims, damages, and expenses, including, without limitation, attorneys' fees and expenses that arise as a result of the negligence or intentional misconduct of Contractor or any of its agents, officers, employees, or subcontractors.

LEGALESE

Indemnification: To make one whole; to reimburse for a loss already incurred.

Licenses and Permits Clause

The contractor represents and warrants that it has in effect all licenses, permits, and other authorizations or approvals necessary to provide the services from all applicable governmental entities, and that such licenses and permits shall be maintained and in full force and effect for the length of this contract. The revocation, suspension, or withdrawal of any license, permit, authorization, or approval shall be immediately reported in writing by the contractor, and in such an event, the contract will be suspended. The contractor shall provide evidence that all such licenses, permits, and other authorizations are in effect at the signing of this contract and at any time during its length at the request of the owner.

Figure 5.3 Licenses and permits clause.

To better understand indemnification, consider the case of Melissa Norin, the manager of a restaurant located near an interstate highway. Melissa hired Twin Cities Signs Company to change the lights in a 60-foot-high road sign advertising the restaurant. While completing this work, a Twin Cities truck collided with a car parked in the restaurant's parking lot. The car owner approached Melissa, demanding that the restaurant pay for the car's damages. Without an indemnification clause in the contract for services with Twin Cities, Melissa's restaurant might incur expenses related to the accident.

Certainly, it is a good idea to have all contracts reviewed by legal counsel, but because of the significance of indemnification, this clause in a contract should be written only by a competent attorney.

Nonperformance Clauses

Often, it is a good idea to decide beforehand what two parties will do if the contract terms are not fulfilled. In the case of purchasing products and services, the simple solution may be for the hospitality manager to buy from a different vendor. If, for example, a fresh-produce vendor who has contracted with a group of family-owned restaurants frequently misses delivery deadlines or delivers poor-quality products, the nonperformance solution might simply be to terminate the contract. Language would need to be written into the contract that would address the rights of the restaurant group to terminate the agreement if the vendor consistently performed unsatisfactorily.

In some cases, nonperformance on the part of the vendor can have an extremely negative effect on the hotel or restaurant. If, for example, a hotel books a well-known entertainer as a major component in a weekend package, the failure of that entertainer to perform as scheduled would have a significant negative impact on the hotel. It is very likely that the reputation of the hotel would suffer, because it promised its guests something it did not deliver. The guests are likely to demand refunds in such a situation, and the potential that one or more of them could bring litigation against the hotel is very real.

In addition to the costs incurred due to unhappy guests, the cost of replacement entertainment might be quite high if the original entertainer canceled on short notice. Figure 5.4 is an example of nonperformance contract language that might be used to protect the hotel in such a case.

When nonperformance by a vendor will cause a negative effect on the hospitality operation, it is critical that language be included in the contract to protect the operation. The protection may be in general terms, such as the clause below, or it may be quite specific. A common way to quantify nonperformance costs is to use a "dollars-per-day" penalty. In this situation, the vendor is assessed a penalty of agreed-on "dollars per day" if it is late in delivering the product or service.

Entertainer Nonperformance Clause

The “Entertainer” recognizes that failure to perform hereunder may require Hotel to acquire replacement entertainment on short notice. Therefore, any failure to provide the agreed-upon services at the times, in the areas, and for the duration required hereunder shall constitute a default, which shall allow the Hotel to cancel this contract immediately on oral notice. The “Entertainer” and or his or her agent shall be liable for any damages incurred by the Hotel, including without limitation, any costs incurred by the Hotel to secure such replacement entertainment.

Figure 5.4 Entertainer nonperformance clause.

Dispute Resolution Terms

In some cases, it is a good idea for contracting parties to agree on how to settle any disputes that may arise before they actually occur. To do so, several issues may need to be addressed. The first is the location of any litigation undertaken. This is not a complex issue when both parties to the contract and their businesses are located in the same state. When the contract is between two parties that are not located in the same state, contract language such as the following could be inserted into the contract:

This agreement shall be governed by and interpreted under the laws of the State of _____ [location of business].

Additional terms may include the use of agreed-on, independent third parties to assist in problem resolutions. Litigation costs are another area of potential disagreement that can be addressed before any contract problems arise. Language such as the following makes clear who is responsible for the costs associated with contract litigation:

Should any legal proceedings be required to enforce any provisions of this Agreement, the prevailing party shall be entitled to recover all of its costs and expenses related thereto, including expert witness’ and consultants’ fees and attorneys’ fees.

Exculpatory Clauses

LEGALESE

Exculpatory clause (or contract): A contract, or a clause in a contract, that releases one of the parties from liability for his or her wrongdoings.

In addition to the essential elements related to providing and receiving products and services just listed, some hospitality managers would add an *exculpatory clause*, especially when providing products and services to guests. These clauses seek to exculpate, or excuse, the hospitality operator from blame in certain situations. An example would be a sign in a pool area that states “Swim at Your Own Risk,” or a clause in a meeting space contract that states “Operator not responsible for materials left in meeting rooms overnight.” Although these clauses may help reduce litigation, it is important to understand why this is so. Exculpatory clauses generally cause guests to exercise greater caution. Warning signs or contract language that cause guests to be more careful truly will work in the favor of both guests and the hospitality organization. In addition, some parties to a contract may accept the exculpatory statement as legal truth. That is, they will assume that they have somehow given up their right to a claim against the hospitality organization because of the exculpatory clause’s language.

It is very important to note, however, that the courts have not generally accepted the complete validity of exculpatory clauses. In some cases, they do in fact exculpate; in others, they do not. Consequently, exculpatory clauses have the disadvantage of sometimes providing a false sense of security to the operator. In summary, these clauses can be useful, but they should not be relied upon to absolve the operator of his or her reasonable responsibilities to care for the safety and security of guests.

» ANALYZE THE SITUATION 5.1

LAUREEN STATTE WAS A guest at the Vacation Inn Express, a mid-priced, limited service hotel in an urban area. When she checked into the hotel, she inquired about the availability of a workout room. Upon receiving assurances that the hotel did indeed have such an area, Ms. Statte checked into the hotel, put away her luggage, changed into workout attire, and proceeded to the workout area.

Upon entering the workout room, she noticed a sign prominently posted near the entrance to the workout room stating: "Hotel Not Liable for Any Injuries Incurred During Workouts."

According to her attorney, Ms. Statte lifted deadweights for approximately 10 minutes, and then mounted a treadmill. As an experienced treadmill user, she started slowly, gradually increasing the treadmill's speed. Shortly after beginning the treadmill workout, Ms. Statte fell backward into a plate-glass window that was approximately 2 feet behind the treadmill. The glass shattered, and shards from the glass severely injured Ms. Statte.

Ms. Statte's attorney claimed the accident was the fault of the hotel because the treadmill was too close to the window, and the hotel neglected to outfit the windows with safety glass. As its defense, the hotel pointed out the presence of the exculpatory clause sign, clearly posted, that Ms. Statte agreed she had read prior to beginning her workout.

1. Do you believe a guest who has agreed to be responsible for her own injuries during a workout has also agreed to be responsible for them in the presence of significant negligence on the part of the hotel?
2. As the hotel manager, how might you resolve this dispute?
3. Could a lawsuit have been prevented?

5.2 FRANCHISE CONTRACTS

In Chapter 3, you learned that franchising is a business strategy that allows one business entity to use the logo, trademarks, and operating systems of another business entity for the benefit of both. Because of the potential for abuse, the laws and contract language that govern the advertising for sale and purchase of franchises are closely

regulated and complex. As well, the language of the franchise agreements that control the actions of franchisor and franchisee are typically very detailed and, as a result, must be well understood by both of these parties.

Purchasing a Franchise

LEGALESE

Disclosure: To reveal fully and honestly.

Evaluating and purchasing a franchise is a very complex undertaking. This can be made even more difficult if the companies selling franchises are not open and honest in the description of their offerings. In the past, some franchisors, in some industries, were fraudulent or deceptive in their claims. Because of this, detailed regulations and laws have been enacted that specify *disclosure* requirements that franchisors must follow when, as shown in the example in Figure 5.5, they advertise their franchise for sale.

The Franchise Rule

The Federal Trade Commission (FTC), through its mandate to regulate unfair or deceptive trade practices, is the government agency assigned the task of regulating the offering of franchises. To do so, the FTC requires all franchisors to supply information that it feels is necessary for a potential franchisee to make an informed buying decision. (The types of information that franchisors must disclose will be discussed later in this section.) It is important to note that while the FTC requires that certain information be disclosed, it does not verify the accuracy of that information. Figure 5.6 is a statement from the FTC that must be prominently displayed on the cover or first page of a disclosure document, which the franchisor is required to supply to anyone considering purchasing a franchise.

In the mid-1970s, the FTC developed a document titled “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,” which took effect on October 21, 1979. Commonly known as the Franchise Rule, it establishes detailed disclosure requirements for franchisors. Figure 5.7 is an excerpt from the FTC Franchise Rule. Note the very specific information it requires franchisors to disclose.

Revised Franchise Rule

In January 2007, the Federal Trade Commission approved amendments to the Franchising Trade Regulation Rule. The changes were optional from July 1, 2007, until July 1, 2008. After July 1, 2008, the changes became mandatory for all franchisors. The major changes in the new Franchise Rules occur in the areas of disclosures and exemptions.

The rules governing the content of the disclosures, as well as the substance of the disclosures, have been changed. Franchisors must now disclose franchisor-initiated litigation against franchisees. Additionally, franchisors no longer have to disclose franchise brokers. If current or former franchisees have signed confidentiality clauses in franchisor agreements in the last three years, the disclosure document must contain language about the existence of such clauses. However, the most significant change is the requirement of a fully reconciled summary of the inflow and outflow of franchised and company-owned outlets over the course of each year. Safeguards are in place to avoid double-counting certain events.

Procedures for disclosures have changed, as well. Franchisors can now deliver the disclosure document not only in hard copy or CD-ROM format but also through email or through the franchisor’s website. The disclosure document must be delivered no later than 14 calendar days before the franchisee signs any agreement or pays any money. Last, the final franchise agreement must be disclosed to the franchisee at least seven calendar days before the franchisee executes it.

Crystal's Coneys and Chips

The International Franchise Leader in Coney Dogs and Fries

Crystal's Coneys and Chips is the worldwide segment leader in take-out Coney dogs and freshly made French fries (chips). There's a good reason why. Our franchisees realize that the support, training, and marketing assistance available through Crystal's Coneys and Chips (CC&C) ensure them the highest possible return on investment. It's true in Frankfort, Kentucky, as well as Frankfurt, Germany!

America and the world love Coney dogs and chips. At CC&C we have developed the very best recipes for both of these popular items. This means strong customer counts and strong revenues. Strong revenues mean a strong bottom line, and that's why our franchisee retention rate is second to none in the industry.

Ninety percent of our 500-plus stores are franchisee-owned and -operated. CC&C operates only 10 percent of them. That's why we know that listening to you, not competing with you, makes us both successful.

We can assist in site selection, financing, and start-up. Our franchise fees and start-up costs are low. If you are serious about your future in the Coney dog and chips market, e-mail Maureen Pennycuff, international director of franchise sales at mpennycuff@cc&c.com, or visit our Web site at

www.cc&c.com

***This is the one franchise opportunity
that you can't afford to miss!***

Figure 5.5 Fictional representation of the type and style of information typically placed in an advertisement for a franchise that would be found in the hospitality trade press.

Federal Trade Commission Warning Statement

To protect you, we've required your franchisor to give you this information. *We haven't checked it and don't know if it's correct.* It should help you to make up your mind. Study it carefully. While it includes some information about your contract, don't rely on it alone to understand your contract. Read all of your contract carefully. Buying a franchise is a complicated investment. Take your time to decide. If possible, show your contract and this information to an advisor like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, you should let us know about it. It may be against the law.

There may also be laws on franchising in your state. Ask your state agencies about them.

Figure 5.6 Franchise warning statement.

FTC Franchise Rule [Excerpt]

Title 16—Commercial Practices; Revised as of January 1, 1986

CHAPTER I—FEDERAL TRADE COMMISSION

SUBCHAPTER D—TRADE REGULATION RULES

PART 436—DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING AND BUSINESS OPPORTUNITY VENTURES

16 CFR 436.1

In connection with the advertising, offering, licensing, contracting, sale, or other promotion in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, of any franchise, or any relationship which is represented either orally or in writing to be a franchise, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for any franchisor or franchise broker:

- (a) To fail to furnish any prospective franchisee with the following information accurately, clearly, and concisely stated, in a legible, written document at the earlier of the "time for making of disclosures" or the first "personal meeting":
 - (1)
 - (i) The official name and address and principal place of business of the franchisor, and of the parent firm or holding company of the franchisor, if any;
 - (ii) The name under which the franchisor is doing or intends to do business; and
 - (iii) The trademarks, trade names, service marks, advertising or other commercial symbols (hereinafter collectively referred to as "marks") which identify the goods, commodities, or services to be offered, sold, or distributed by the prospective franchisee, or under which the prospective franchisee will be operating.
 - (2) The business experience during the past 5 years, stated individually, of each of the franchisor's current directors and executive officers (including, and hereinafter to include, the chief executive and chief operating officer, financial, franchise marketing, training and service officers). With regard to each person listed, those persons' principal occupations and employers must be included.
 - (3) The business experience of the franchisor and the franchisor's parent firm (if any), including the length of time each:
 - (i) Has conducted a business of the type to be operated by the franchisee;
 - (ii) Has offered or sold a franchise for such business;
 - (iii) Has conducted a business or offered or sold a franchise for a business:

Figure 5.7 FTC Franchise Rule excerpt

- (A) operating under a name using any mark set forth under paragraph (a)(1)(iii) of this section, or
- (B) involving the sale, offering, or distribution of goods, commodities, or services which are identified by any mark set forth under paragraph (a)(1)(iii) of this section; and
- (iv) Has offered for sale or sold franchises in other lines of business, together with a description of such other lines of business.
- (4) A statement disclosing who, if any, of the persons listed in paragraphs (a) (2) and (3) of this section:
 - (i) Has, at any time during the previous seven fiscal years, been convicted of a felony or pleaded nolo contendere to a felony charge if the felony involved fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade;
 - (ii) Has, at any time during the previous seven fiscal years, been held liable in a civil action resulting in a final judgment or has settled out of court any civil action or is a party to any civil action:
 - (A) involving allegations of fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade, or
 - (B) which was brought by a present or former franchisee or franchisees and which involves or involved the franchise relationship; Provided, however, That only material individual civil actions need be so listed pursuant to this paragraph (4)(ii), including any group of civil actions which, irrespective of the materiality of any single such action, in the aggregate is material;
 - (iii) Is subject to any currently effective State or Federal agency or court injunctive or restrictive order, or is a party to a proceeding currently pending in which such order is sought, relating to or affecting franchise activities or the franchisor-franchisee relationship, or involving fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade.

Such statement shall set forth the identity and location of the court or agency; the date of conviction, judgment, or decision; the penalty imposed; the damages assessed; the terms of settlement or the terms of the order; and the date, nature, and issuer of each such order or ruling. A franchisor may include a summary opinion of counsel as to any pending litigation, but only if counsel's consent to the use of such opinion is included in the disclosure statement.

- (5) A statement disclosing who, if any, of the persons listed in paragraphs (a) (2) and (3) of this section at any time during the previous 7 fiscal years has:
 - (i) Filed for bankruptcy;
 - (ii) Been adjudged bankrupt;
 - (iii) Been reorganized due to insolvency; or
 - (iv) Been a principal, director, executive officer, or partner of any other person that has so filed or was so adjudged or reorganized, during or within 1 year after the period that such person held such position in such other person. If so, the name and location of the person having so filed, or having been so adjudged or reorganized, the date thereof, and any other material facts relating thereto, shall be set forth . . .

The Rule is a trade regulation rule with the full force and effect of federal law. The courts have held it may only be enforced by the FTC, not private parties. The FTC may seek injunctions, civil penalties and consumer redress for violations.

The Rule is designed to enable potential franchisees to protect themselves before investing by providing them with information essential to an assessment of the potential risks and benefits, to meaningful comparisons with other investments, and to further investigation of the franchise opportunity.

The Rule, formally titled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures," took effect on October 21, 1979, and appears at 16 C.F.R. Part 436.

Figure 5.7 (Continued)

The amended rules have exempted certain franchise relationships. Purchases by owners, officers, or managers of franchisors are not covered by the new rules. If the franchisee has been in business for five years and has a net worth of \$5 million, then the new Franchise Rules do not apply. If the franchisee's initial investment is larger than \$1 million (excluding the value of the real estate and any amounts provided by franchisor), then the new rules do not apply. Last, the amended rules do not apply if the franchise location is outside the United States.

For more information, please visit www.ftc.gov/opa/2007/01/franchiserule.shtm.

Search the Web 5.2

Visit www.ftc.gov/bcp/franchise/16cfr436.shtm.

Read the entire FTC Franchise Rule (16 CFR Part 436), to familiarize yourself with its requirements, and then write a one-page bulleted summary of the rule.

The Franchise Rule imposes six different requirements in connection with the “advertising, offering, licensing, contracting, sale, or other promotion” of a franchise:

1. *Basic disclosures:* Franchisors are required to give potential investors a basic disclosure document at the earlier of the first face-to-face meeting or ten business days before any money is paid or an agreement is signed in connection with the investment (Part 436.1(a)).
2. *Earnings claims:* If franchisors make earnings claims, whether historical or forecasted, they must have a reasonable basis for those claims, and evidence supporting the claims must be given to potential investors in writing at the same time as the basic disclosures (Parts 436.1(b)–(d)).
3. *Advertised claims:* The rule affects only promotional ads that include an earnings claim. Such ads must disclose the number and percentage of existing franchisees that have achieved the claimed results, along with cautionary language. The use of earnings claims in promotional ads also triggers required compliance with the rule's earnings claim disclosure requirements (Part 436.1(e)).
4. *Franchise agreements:* The franchisor must give investors a copy of its standard-form franchise agreement and related agreements at the same time as the basic disclosures; and final copies intended to be executed at least five business days before signing (Part 436.1(g)).
5. *Refunds:* Franchisors are required to make refunds of deposits and initial payments to potential investors, subject to any conditions on refundability stated in the disclosure document (Part 436.1(h)).
6. *Contradictory claims:* Although franchisors are permitted to supply investors with any promotional or other materials they wish, no written or oral claims may contradict information provided in the required disclosure document (Part 436.1(f)).

The Franchise Offering Circular

Some states have franchise investment laws that require franchisors to provide presale disclosures, known as franchise offering circulars (FOCs) to potential franchisees. These states treat the sale of a franchise like the sale of a security. They typically prohibit the offer or sale of a franchise within their governance until a

company's FOC has been filed of public record with, and registered by, a designated state agency.

Those states with disclosure laws give franchise purchasers important legal rights, including the right to bring private lawsuits for violation of the state disclosure requirements. The FTC keeps a record of those states that require franchisors to provide FOCs. Potential franchise purchasers who reside in states that have these requirements should contact their state franchise law administrators for additional information about the protection these laws provide.

The FOC is a document designed to encourage the purchase of a franchise. These circulars generally will follow a format patterned after the FTC's Franchise Rule. It is important to remember, however, that the FTC does not verify, as factual, the information contained in a circular. Because this is true, the documents making up the FOC should, like all contracts, be read very carefully.

The following information must be included in an FOC. This information is requested by states that require FOCs, in accordance with guidelines established by the FTC. After reading these items, you may realize that these state requirements are almost identical to the FTC's own disclosure requirements in the Franchise Rule:

- A description of the franchisor and the type of license it is offering
- The business experience of the franchise company's owners and/or managers
- Initial fees, continuing fees, and royalties if required
- Initial investment estimates
- The licensee's obligations
- The licensor's obligations
- Policies about the geographic territory protected by the license agreement
- Restrictions on what the licensee may sell and how it may be sold
- Renewal and termination policies
- Transfer of ownership policies
- Claims regarding average earnings or profitability of current franchisees
- Locations of current franchisees
- A sample franchise (license) agreement
- Any information required by a specific state (e.g., California, Utah, or Maine)
- The name and address of the legal representative of the franchisor

Additional items may be included based on state law, FTC requirements, and the specific nature of the franchise. Again, it is important to remember that one of the goals of the FOC is to facilitate the selling of franchises. As with any disclosure, those who prepare it should be honest, or they face possible litigation for deception. Similarly, those who read the document for purposes of purchasing a franchise should be prepared to verify, to the greatest degree possible, the information it contains.

Franchise Contracts

If, after reviewing the FOC, an owner elects to execute a contract with a franchisor, then the two parties will sign a special form of hospitality contract called a *franchise agreement*.

The franchise agreement is the document that actually regulates the relationship between franchisee and franchisor. It is important to ensure that the information in the circular is consistent with that found in the franchise agreement. Because the franchise agreement details the rights and responsibilities of both the franchisor and franchisee, the document will directly address the following topics:

- License granted
- Franchisee responsibilities

LEGALESE

Franchise agreement:

A special hospitality contract that details the responsibilities of both parties (franchisor and franchisee) involved in the operation of a franchise.

- Franchisor responsibilities
- Proprietary rights
- Audit requirements
- Indemnification and insurance requirements
- Transfer of ownership policies
- Termination policies
- Renewal options
- Relationship of the parties to the contract
- Areas of protection
- Terms of the agreement (start and stop dates)

The franchise agreement is a critical contract in that it spells out in detail the rights and responsibilities of both the franchisor and franchisee. As such, it should be carefully read and examined by an attorney. For a hospitality manager whose responsibilities include operating a franchise, either as an owner or as an employee hired by the owners, it is imperative that the contract terms be followed. If they are not, the franchisor may have the right to terminate the contract.

It is important to understand that, in most cases, franchise companies do not actually own the hotels operating under their brand names. Franchise companies such as these own, instead, the right to sell the brand name and determine the standards that will be followed by those hotel owners who do elect to affiliate with their brands. With the ownership of a hotel vested in one business entity and the responsibility for brand standards resting with another business entity, it is not surprising that conflict can arise between the hotel's owners and the brand managers. For example, assume that the managers of a given brand decide that the bedding for their brand, and thus the mattresses, bedspreads, sheet quality standards, and pillow sizes, are not in keeping with the quality of that provided by competing brands. The brand managers may have the authority, under the franchise agreement, to require affiliated hotel owners to update their bedding. The owners, however, facing significant purchase and replacement costs for bedding that is in perfectly good condition, but that has been declared "substandard" by the brand managers, might attempt to resist the purchase of the new items. In fact, franchised hotel owners may disagree with their brand managers about numerous operating issues.

Because franchisors are generally in a stronger bargaining position than the franchisee, the franchise agreement is often heavily weighted in favor of the franchisor. However, like any contract, the franchise agreement is a negotiable document. Up-front fees or application fees, monthly royalties, areas of protection, required purchases, or renovations to facilities are all contract areas that can be negotiated prior to signing the franchise agreement. Difficulties and misunderstandings can arise between franchisors and franchisees, even when details seem to be clearly spelled out in the contract. Some of the most glaring areas of tension center on specific ways of operating the business, and balancing the needs of the franchisee with those of the franchisor.

The franchise agreement is, in the final analysis, simply a contract between the brand's managers and the hotel's owners. As such, it is negotiable. The stronger the position of each side, the more power each will bring to the negotiating process. It is always in the best interest of the business's owners to be represented by an attorney during the franchise agreement finalization period because these agreements are detailed and complex. In the opinion of many, franchise agreements, which are drafted by the franchisor, tend to be written in the favor of the franchisor. Because this is true, owners should carefully read every line of the franchise agreement to determine exactly what they must do to stay in compliance with the agreement, as well as the penalties that will be incurred if they do not stay in compliance.

To become familiar with some of the many areas of potential conflict between the manner in which franchisors and franchisees interpret management agreement terms and clauses, follow the instructions in Search the Web 5.3.

Selling a Franchise

Selling a nonfranchised business is sometimes complex. However, selling a franchise can be even more difficult, because, in most franchise contracts, the sale of a franchise will generally require approval from the franchisor. The franchisor's rationale is clear: It is in their best interest to ensure that any owner who takes over a franchise indeed meets the requirements the franchisor has set out for its franchisees. This is, of course, a legitimate interest. It results, however, in a situation that places restrictions on the seller.

In some cases, the franchisor retains the *right of first refusal* in a franchise sale. In other cases, such as that in Figure 5.8, the franchisor will insert a clause in the franchise agreement that requires notification in the event of a pending sale. Should the new buyer elect not to renew the franchise, the franchisee may have to pay a termination fee to the franchisor.

When an independent restaurant or lodging facility owner elects to sell his or her business, he or she is free to determine a suggested selling price, advertise that

LEGALESE

Right of first refusal: A clause in a contractual agreement between two parties in a business relationship in which one party, upon termination of the business relationship, can exercise the right to buy the interest of the other party before those rights can be offered for sale to another.

Search the Web 5.3

Go to www.hospitalitylawyer.com.

1. Select: Resources.
2. Select: Academics.
3. Select: Hospitality Law Textbook Support.
4. Select: Click Here for Fourth Edition Reference Cases.
5. Select "Joint Franchisor-Franchise Relations by Robert Zarco, Richard Barrett-Cuetara, and Andrew Loewinger Presented at the Third Annual Hospitality Law Conference."
6. Review this article, and be prepared to discuss it in class.

Notification/Nonassumption Clause

In no event shall owner offer the hotel through public auction or through the media of advertising, either in newspapers or otherwise, without first obtaining the written consent of franchisor, which shall not be unreasonably withheld.

If in the event of the sale of the hotel the purchaser fails to assume owner's obligations hereunder, or in the event franchisor shall have elected to terminate this agreement, then owner agrees to pay to franchisor as liquidated damages and not as a penalty, no later than the closing, or 10 days following the effective date of such termination, a termination fee in an amount equal to the greater of 12 times the average monthly fees earned by the franchisor during the preceding 12 months or 12 times the basic fees projected in the current year's operating budget.

Figure 5.8 Right of first refusal clause.

Agency Relationship Clause

The franchisee is an independent contractor. Neither the franchisee nor franchisor is the legal representative or agent of the other. No partnership, affiliate, agency, fiduciary responsibility, or employment relationship is created by this agreement.

Figure 5.9 Agency relationship clause.

the business is for sale, and sell the business as he or she sees fit. When a franchisee wants to sell his or her business, however, the franchisor often requires that the buyer sign the current franchise agreement, which most often contains materially different financial terms from those in the selling franchisee's agreement. What the buyer is buying is often different from what the seller is selling.

Owning a franchise is an effective way for many entrepreneurs to improve their odds of success when starting a business. Investigating the many different alternatives available from various franchisors is an important part of this process. From a legal standpoint, the manager of a franchise operation has the dual burden of operating in such a way as to satisfy both the owners of the operation and the franchisor. When conflicts occur between the best interests of the ownership and those of the franchisor, it is important to remember where the agency relationship lies. In fact, language inserted by the franchisor in a franchise agreement is typically very clear about that issue, as can be seen in Figure 5.9.

5.3 MANAGEMENT CONTRACTS

LEGALESE

Management agreement:

The legal agreement that defines the responsibilities of a business owner and the management company chosen to operate the owner's business. Also known as a "management contract."

In Chapter 3 you learned that some hospitality business owners choose to allow another entity to operate their businesses. When they do so, the terms and conditions of the operating arrangement are documented in a management contract, or as it is also known, a *management agreement*.

Management companies are common in all segments of the hospitality industry. As a result, a great number of hospitality managers will, during their careers, work directly or indirectly with a management company. Because that is true, it is important that you understand how management companies are structured, the manner in which the management contracts (agreements) under which they operate are developed, and the unique relationship that results when an owner selects a management company to operate a franchised business.

Management Companies

A management company is an organization formed for the express purpose of managing one or more businesses. Management companies may be classified in a variety of ways, such as the industry segment in which they operate, their geographic location, and their size. From a legal perspective, however, one important way to classify management companies is by the ownership interest they have in the businesses they operate. This relationship can take a variety of forms, including these four:

1. *The management company is neither a partner nor an owner of the business it manages.* In this situation, the business's owners simply hire the management company. This is common, for example, when lenders

involuntarily take possession of a business. In other cases, the management company may, for its own philosophical reasons, elect to concentrate only on managing properties and will not participate in business investing (ownership).

2. *The management company is a partner (with others) in the ownership of the business's they manage.* Although this common arrangement exists in many segments of hospitality, it is especially popular within the hotel industry. Frequently, in this situation, the management company either buys or is given a portion of business ownership (usually 1 to 20 percent), and then assumes the management of the property. Those business owners who prefer this arrangement feel that the partial ownership enjoyed by the management company will result in better performance by them. However, if the business experiences losses, the management company will share in these losses, and this fact can help serve as a motivator for the management company!
3. *The management company only manages businesses it owns.* Some management companies form simply to manage the businesses they themselves own. These companies want to participate in business as both investors and managers. Clearly, an advantage of this situation is that the management company will benefit from its own success if the businesses it manages are profitable. If the company is not successful, however, it will be responsible for any losses incurred in its operations.
4. *The management company owns, by itself, some of the businesses it manages, and owns a part, or none at all, of others it manages.* To understand better the complexities of the various scenarios under which a management company can function, consider a very successful hotel management company operating in a large city. The company decides to vary its ownership participation in the businesses it manages, depending on the individual hotel it manages. Thus, in this example, the hotel management company might:
 - Own 100 percent of one or more hotels it manages.
 - Manage and be a partial owner of other hotels.
 - Manage, but not own any part of, yet another hotel property.

In each of the situations just described, it is important, as you learned previously, for hospitality managers actually employed by the management company to clearly understand the fiduciary responsibilities that accompany their employment (see Chapter 3).

Types of Management Contracts

Not surprisingly, there are as many different contracts between those who own businesses and the management companies they employ to manage them as there are businesses under management contract. Each business owner might, depending on the management company selected, have a unique management contract, or operating agreement, for every business owned. In some cases, these contracts may include preopening services provided before the business is officially open and may even include activities related to the sale of the business.

Management contracts can be complex and their terms subject to diverse interpretation. In his 1980 book *Administration of Hotel and Restaurant Management Contracts*, James Eyster detailed many of the components typically included in hospitality management agreements. Considered a classic work in the field of management contracts, it is an excellent examination of the complexities of hospitality contracts and issues. This is so because, while times have changed since 1980, and

certainly, each specific management contract is different, many of the negotiable issues identified in Eyster's book must still be addressed by owners and prospective management companies when they are discussing a potential management agreement:

- The length of time the agreement is to be in effect
- Base fees to be charged
- Incentives fees earned or penalties assessed related to operating performance
- Contract terms in the event of the business's sale
- Management company investment required or ownership required
- Procedures for early termination by either party
- Procedures for extending the contract
- Exclusivity (Is the management contract company allowed to operate competing businesses?)
- Reporting relationships and requirements (how much reporting detail is required and how frequently will reports be produced)
- Insurance requirements of the management company (who must carry the insurance and how much)
- Employee status (Are the business's employees employed by the owner of the business or the management company?)
- The control, if any, that the owner has in the selection or removal of the business's management personnel

The interests of hotel owners and the management companies they employ frequently conflict, and these conflicts can sometimes become highly publicized. On the surface, it would seem that the interests of a business owner and the management company selected to operate its business would always coincide. Both the owner and management company, it would seem, are interested in operating a profitable business. In fact, however, disputes arise because business owners will typically seek to minimize the fees they pay to management companies (because reduced fees yield greater owner profits), while management companies, of course, seek to maximize their fees.

Owners who hire management companies often have serious disagreements with those companies over whether the businesses they manage are indeed operated in the best interest of the owners. There are various reasons for these disagreements. For example, in a typical management contract, the owner absorbs the costs of management company errors. Unlike a lease arrangement, in a management contract it is generally the owner, not the management company, that is responsible for all costs associated with operating the business. As a result, the unnecessary costs incurred as a result of any errors in marketing or operating the business are borne not by the management company making the errors but, rather, by the business's owner.

For another example of potential owner/management company conflict, consider that recent lawsuits filed by owners against management companies focus on the issue of how management companies purchase goods and services for the businesses they manage. Management companies in the hospitality industry are responsible for purchasing billions of dollars worth of products, including, for example, food, furniture, fixtures, in-room amenity items, computers, and software, as well as services such as insurance, long-distance telephone, credit card processing, and payroll preparation services. Difficulties can arise when management companies, who are authorized by their management contracts to make purchases on behalf of owners, reap the benefits that accrue to large volume buyers. In some cases, large management

companies have negotiated contracts with literally hundreds of manufacturers and suppliers. These contracts produce millions of dollars of rebates directly from the vendors back to the management company. The management company may retain these rebates and, in fact, may even operate their purchasing departments as separate profit centers. In other cases, the management company may have an equity investment in some of the vendors companies, or in the most egregious of cases, may even own the vendor company outright. Although these types of arrangements are not automatically illegal, they must be disclosed to the owners of the businesses for whom the management company is under contract and to whom is owed a fiduciary duty.

It is important to remember that agency law requires agents to place their principals' interest over their own, precludes agents from competing with their principals, and precludes self-dealing. That is, agents might not operate on their own behalf without disclosure to and approval of their principals. If rebates received by a management company, as in this example, are not disclosed to the business's owner, they might cease being rebates and simply become vendor *kickbacks*.

LEGALESE

Kickback: A secret rebate of part of a purchase price, given by the seller, to the buyer, in exchange for the buyer's influence in the purchasing decision.

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5. Select "Management Contracts Litigation Update by David Moseley Presented at the Third Annual Hospitality Law Conference."
6. Review this article, and be prepared to discuss it in class.

Ethical issues arise when a management company directly receives a benefit (discounts, commissions, or rebates) based on purchases made on an owner's behalf. Should those benefits accrue to the owner or the management company? The answer should be clearly spelled out in the management contract.

Management Contracts for Franchised Properties

As you have learned, a hospitality business, and especially hotels may:

- Operate as a franchise
- Operate under a management contract

As well, a business may operate as a franchise and be operated under a management contract. Just as special legal issues arise when operating a business as a franchise and when operating under a management contract, issues also arise when operating a franchise business under a management contract. To better understand the legal issues that may occur in an operating arrangement that includes both a

franchise and management company, it is instructive to examine, as an example, the hotel segment of the hospitality industry.

Hotel owners often find themselves in some level of conflict with, or, at the very least, in disagreement with, franchisors about how to best manage the franchised brand; as well as how to operate the individual hotels making up the brand. For example, assume that the franchisor for a hotel brand has, as a brand standard, established breakfast hours for the hotel's complimentary continental breakfast to be from 6:00 A.M. to 9:00 A.M. Assume, also, that the hotel is operated, for its owners, under a management contract.

The hotel's owners have instructed the management company to begin the breakfast at 7:00 A.M., rather than 6:00 A.M. on the weekends, to reduce labor costs. If the management company follows the directive of the brand managers, it has violated the owner's wishes (but fulfilled the terms of the franchise agreement); however, if it follows the clear instructions of the hotel's owner, it will be in violation of a brand standard and thus the owner's franchise agreement.

When owners instruct management companies to violate or ignore brand standards, the resulting influence on the hotel's relationship with the brand can be negative. Alternatively, when brand managers seek a management company's compliance with acts that may be in the best interest of the brand managers, but not necessarily the hotel's owners, difficulties may also arise. This will, in most cases, be true despite the claims of franchisors that all of their actions are undertaken in the best interest of the brand's franchisees.

Even when a hotel's owners do not intentionally initiate brand-related conflict with their management companies, it can still occur. For example, assume that those brand managers responsible for selling franchises to owners were successful in convincing a hotel's owners to reflag (choose a new brand) their property. Assume also that this owner employs a management company to operate the hotel.

After one year of operation, the owner complains to the franchise company that the number of reservations received through the franchisor's national reservation center is not consistent with the amounts verbally promised by the brand's sales representatives. In fact, complain the owners, the volume of reservations received is only about one-half of that promised. In cases such as these, it is not at all unusual (and in fact is most likely), that the brand managers will claim that it is the management company operating the hotel, and not the brand, that is the cause of the shortfall. Not surprisingly, the management company is highly unlikely to agree with this assessment. The potential for resulting conflict is clear. This is simply one example of possible brand versus management company conflict.

As you learned, sometimes a management company owns all or part of the hotel it operates. In most arrangements, however, the management company does not own the hotel it operates. The result is that, in some cases, conflicts arise between the management company and the brand (but not the business's owner). Many management companies have excellent relations with the brands they manage for owners, while others do not. This results because, at times, some of the wishes or even the directives of the brand managers are in conflict with the perceived best interest of the management company.

For example, a franchise company might, in an effort to promote business, send to a management company managed hotel several large, exterior banners, that advertise a special rate or hotel feature. Obviously, the brand wants these signs displayed on the property. The management company's sales philosophy, however, might not include hanging large exterior banners around the hotel because it believes such banners cheapen the image of the hotel. Because of this belief, the banners are not displayed. The resulting conflict is actually easy to understand from the perspective of either entity. The conflict should not, however, be allowed to escalate and significantly damage the relationship between the franchisor and management company

because that could easily result in real harm to the long-term best interest of the business and its actual owners.

5.4 CONFERENCE SERVICES CONTRACTS

For many hospitality businesses, and especially for hotels, well-executed contracts related to conference services are vital to the operation's profitability. Conference services contracts are unique in that they are typically executed between a hospitality business and a group. Group business is critical to the success of many hospitality businesses, but it is especially important to hotels and conference centers. Interestingly, however, there is no universally accepted definition of *group* business. Groups may, for example, consist of tour groups, sports teams, conventions, trade shows, corporate training meetings, wedding parties, and special travel packages marketed by the hotel's sales department and other multiroom night users. Despite the specific characteristics of a group, or its reason for meeting, *conference services contracts* detail the terms and conditions of the group's meeting arrangements.

One of the most important components of conference services contracts is the language used to establish and assign responsibility for the group's *master bill*.

Master bills are helpful when one member of the group is responsible for paying all hotel charges. If, for example, a company sponsors a training session for of its employees, it is likely to be most convenient for that company's accountant to pay one invoice for meeting space, meals, and hotel rooms rather than to reimburse individuals for their individual costs. Similarly, a coach traveling with a sports team will likely find a master bill to be the best way to pay for the team's rooms. Master bills, however, and their management are frequently one of the areas of greatest conflict in conference services contracts.

For most hospitality businesses, conference services contracts will take one of two basic forms: meeting and space contracts and group lodging contracts. In many cases, a group may utilize both a hotel's meeting space and its lodging facilities. In such cases, the contract between the group and the hotel will, by necessity, include components found in each of the two basic types of conference services contracts.

Meeting Space Contracts

Although limited-service hotels primarily contract for the sale of sleeping rooms, full-service hotels, as well as conference centers and some other hospitality organizations also offer guests the ability to reserve meeting space, meeting rooms, exhibition halls, and food and beverage services. For example, a large, full-service hotel might contract with a nonprofit organization to provide sleeping rooms, meeting space, and an exhibit hall for the use during the association's annual convention. When this occurs, the rental rate for the space may be tied to the number of sleeping rooms used by the group during its meeting; in other cases, however, the price of the meeting space is not related to the use of sleeping rooms. Since most hotels have limited meeting space, and that space is used primarily as an enticement to sell sleeping rooms, experienced hotel managers must carefully contract for the sale of this space. The meeting space contract utilized by a hotel or conference center allows the manager to set precisely the terms and conditions on the sale of its valuable meeting space and services. Figure 5.10 provides an example of the level of detail typically found in such contracts.

LEGALESE

Conference services

contract: An agreement that details the space, products, and services to be provided to a group before, during, and after its meeting.

LEGALESE

Master bill: A single folio (bill) established for a group that includes specifically agreed-on group charges. Sometimes called a "master folio," "group folio," or "group bill."

Group Lodging Contracts

Although the meeting and space contracts developed by full-service hotels sometimes include provisions for sleeping rooms as well, contracts for “sleeping rooms only” are very common in hotels that do not offer meeting space. Moreover, even full-service hotels frequently have clients who only want to rent sleeping rooms and require few, if any, of the services offered by the hotel. In cases such as these, a group lodging contract will be created to describe the very specific conditions under which the group will hold and pay for the rooms it desires.

MEETING CONFIRMATION	
DATE:	
ORGANIZATION:	
CONFERENCE:	
GROUP CONTACT:	
TITLE:	
PHONE:	FAX:
ADDRESS:	

KEY DUE DATES: For your convenience, we have listed key dates mentioned within this Meeting Confirmation for your reference. Please review the corresponding sections for further information.

- Acceptance/Signed Meeting Confirmation
- Credit Arrangements/Completed Credit Application
- Reservation Cutoff
- Program Details/Menu Selections
- Three Days Prior to Scheduled Events
- Food and Beverage Guarantees

PROGRAM SPECIFICS:
DATES:
DAY:
DATE:
SINGLES:
DOUBLES:
CONCIERGE:

Figure 5.10 Group meeting contract.

Check-in time is 4:00 P.M.; check-out time is 12:00 P.M.; late checkout is \$15.00 per hour until 4:00 P.M., after which time a full day's charge will apply. Complimentary luggage storage is available.

GUESTROOM RATES

Singles:

Doubles:

Concierge Level: \$40 additional

Early Arrival:

Late Departure:

The above room rates are subject to prevailing taxes, which are currently at 17%.

DAY MEETING PACKAGE RATES (for all meeting attendees):

Subject to 8.25% sales tax and 20% service charge

This DAY GUEST PACKAGE RATE includes:

Lunch (Aspen Dining Room): Lunch is available for seating at 11:30 A.M. or 12:30 P.M.

Meeting Room Supplies: Room setup, pads, pencils, ice water pitchers, and hard candies.

Continuous Beverage Service (7:30 A.M.–5:00 P.M.): Coffee, decaf, tea, assorted sodas, and bottled water.

Community Refreshment Breaks

Morning Break (7:30 A.M.–10:30 A.M.): Assorted baked goods (varies daily), sliced fresh fruit, assorted mini-yogurts and orange juice.

Afternoon Break (2:00 P.M.–4:00 P.M.): Assorted afternoon snacks, fresh baked cookies or brownies of the day, candy, whole fresh fruit, and lemonade.

Standard Audio Visual

10–25 people: 2 flipcharts (including markers and masking tape), data projector, screen, podium and easel.

26–50 people: 2 flipcharts (including markers and masking tape), 2 data projectors, 2 screens, standard microphone, VCR/DVD player, easel, and message board.

51–75 people: 3 flipcharts, 2 data projectors, 2 screens, standard microphone, VCR/DVD player, easel, and message board.

76+ people: 4 flipcharts, 2 data projectors, 2 screens, standard microphone, lavalier microphone, VCR/DVD player, easel, and message board.

RESERVATIONS

Procedure

We understand that reservations will be made with a rooming list. A copy of our rooming list is enclosed. The rooming list is to be returned to our office before the cutoff date.

Cutoff Date

All reservations must be received no later than _____. At that time, any uncommitted rooms in your guest room block will be released for general sale,

Figure 5.10 (Continued)

and future reservations will be subject to space and rate availability. A payment guarantee will be required to continue holding guest rooms.

Billing

Arrangements have been made for all individuals to pay for their room, taxes; and incidental charges, and for all group charges be placed on a master account to be paid by the booking organization.

FUNCTION ARRANGEMENTS

We have reserved meeting space as outlined below. Meeting rooms are not held on a 24-hour basis unless otherwise noted. A conference services manager personally assigned to your account will be contacting you to discuss and finalize your exact room setup requirements, menu selections, and audiovisual equipment needs.

Please advise us of all changes to your agenda so that we may best serve your specific program requirements. Should there be a significant reduction in attendees, we serve the right to adjust function space accordingly.

Day	Date	Time	Function	Setup	Attendance
-----	------	------	----------	-------	------------

MEETING ROOM RENTAL

The charge for meeting space will be _____ per break-out per day.

FUNCTION GUARANTEES

A final guarantee of the number of meeting attendees and/or catered food functions is due no later than three (3) business days prior to each scheduled event. This guarantee represents the minimum guest count for billing purposes and may not be reduced after this time.

CREDIT ARRANGEMENTS

Upon our accounting department’s approval of your credit application, your master account will be direct-billed. Our credit terms are “Net due upon receipt of invoice” with interest charged at 1.5% on all balances over 30 days of billing date.

CREDIT APPLICATION

Credit application due: _____

RECEIVING/HANDLING OF PACKAGES

Incoming materials for your meeting should arrive at the hotel no more than three (3) days prior to your meeting date. Packages for your meeting should be addressed to the attention of your hotel service manager, and list the name and date of your meeting. If more than one package is sent, please indicate the number of packages sent by listing, for example, “package 1 of 3” or “package 2 of 3.” Five (5) or fewer boxes will be delivered complimentary to your meeting room. There is a \$1.50 handling and delivery charge for six (6) or more boxes.

CANCELLATION

Acknowledgement of a definite commitment by the Hotel will in good faith, continue to protect the facilities and dates agreed, to the exclusion of other business opportunities. Therefore, the commitment of space and dates is of specified value to the Hotel. Due to the great difficulty in reselling guest

Figure 5.10 (Continued)

rooms and conference space on short notice, cancellation of the entire program will be subject to an assessment according to the following schedule:

0 to 30 days prior to arrival. Full payment on total number of guest rooms, meeting charges, package plans, and any estimated banquet revenues as booked for the duration of the dates agreed upon.

31 to 60 days prior to arrival	75% of the above
61 to 90 days prior to arrival	50% of the above
91 to 180 days prior to arrival	30% of the above
181 days to 1 year prior to arrival	15% of the above
Signing date to one year prior to arrival	10% of above

ATTRITION

The rates and the availability for this program are based on the contracted guest-room block. Therefore, reduction in the guestroom block will be subject to an assessment according to the following schedule:

Up to 60 days prior to arrival: 10% can be reduced without any fee. Additional rooms over the 10% will be charged for one-night guestroom revenue.

60 to 31 days: 10% of the existing block can be reduced without any fee. Additional rooms over the 10% will be charged two nights guestroom revenue.

0 to 30 days prior to arrival: 5% of the existing guestroom block can be reduced without any fees. Rooms reduced over 5% will be charged for the full number of nights they were contracted for.

PROGRAM ALTERATION CONTINGENCY

This agreement has been based on the sequence of days, number of agreed-upon guestrooms, and function requirements specified, If these requirements are significantly changed, we reserve the right to alter the terms and conditions of this contract, including assessment of cancellation fees and availability of specified rooms and rates.

ACCEPTANCE

If the above details meet with your approval, please sign this letter agreement and return to us by_____. If an approved agreement is not received by the above option date, the Hotel will release the tentative space reserved.

We sincerely appreciate the opportunity to serve_____. You can be assured of the effort of our entire staff and my personalized attention to help make your meeting and stay most enjoyable and successful.

ACCEPTANCE BY CLIENT

Name: _____
 Title: _____
 Date: _____

ACCEPTANCE BY HOTEL

Name: _____
 Title: _____
 Date: _____

Figure 5.10 (Continued)

A well-developed group lodging (rooms) contract will include detailed language about a variety of items including:

- The total number of rooms and room nights to be held for the group
- The group's arrival and departure dates
- Negotiated group rates by specific room type or run of house (any room type)
- The *cut-off date* or reservations rooming list due date
- Reservations procedures
- Complimentary rooms (if any) to be credited to the to the master bill
- Disclosure of all fees (including any early departure fees, no-show fees, and the like)
- All room taxes, surcharges, and, if applicable, extra person charges
- Rates applicable to rooms booked after the cut-off or reservations due date
- Whether reservations booked by the groups members for dates just before or just after the group's stay will be counted in the total, cumulative room block
- If there is an early departure fee, who will advise each guest of the policy and whether fees count toward attrition fees, if any
- How room rates will be calculated if the contract is signed prior to the establishment of the group's final room rates

LEGALESE

Cut-off date: The date on which any rooms contracted, and thus held for sale, but not yet picked up (reserved) by the group are returned to the hotel's general rooms inventory.

The existence of group lodging contracts is certainly not new, but the Internet has made this contract type increasingly more complex to develop and, for hoteliers, more difficult to negotiate properly. To better understand why this is so, consider the situation in which a group contracts with a hotel to provide the group's members with sleeping rooms for a date one year in the future. The hotel establishes the rate the group members will pay, and the individual members are to call into the hotel to make their own reservations from the block (group of rooms) reserved for the members.

Assume that, one month prior to the group's arrival, all of the rooms reserved for them have been picked up (reserved) by the group's members. Assume also, however, that the hotel is not full, and its revenue managers elect to offer, online and through the hotel's franchise-affiliated website, a room rate lower than the one offered to the group. Despite the overwhelming tendency of travelers to equate the online rate with the rate at which they have reserved their own room, such rates are not easily comparable. This is because the estimated cost of group giveaways and allowances must be factored into the room rate quoted to the group. As well, when the requests of a group room buyer involve a large amount of meeting space and/or significant numbers of complimentary rooms or services, the hotel may quote a room rate for the block that is equal to or even higher than the hotel's normal transient room rate.

As illustrated in this example, as a myriad of travel websites offer more choices and become easier to use, individuals attending meetings are discovering they can often obtain lower room rates for their stays than the rate that had been quoted to their group. In addition, independent travel companies have begun to aggressively target meetings and convention attendees with e-mails and faxes offering cheaper rooms at nonheadquarters (group host) hotels. As a result, as in this example, a hotel's own revenue managers may lower room rates when a group is meeting in the hotel (e.g., by posting discounted rates on Internet travel sites such as Expedia or Travelocity) to the detriment of the hotel. Inevitably, group members book these lower-priced rooms rather than the ones originally blocked for the group. The result is that the group may not get credit for booking the number of rooms it had originally reserved, thus triggering potential rate increases or penalties. In response, savvy meeting planners have begun to demand the insertion of clauses into their group lodging contracts that exert increased control over room rates that hotels may charge during the period of the group's stay in the hotel. The reason they seek to do so is easy to understand.

Of course, hotel revenue managers seek to maximize the revenue generated by each of their available rooms (RevPAR). Meeting planners, however, will respond

negatively when, for example, a group's negotiated rate of \$200.00 per night is listed in the group lodging contract but, for the same time period, the hotel's revenue managers list \$125.00 per night rooms on an Internet travel site simply because they believe that "any room sale is better than no sale." In a case such as this one, heavily discounting rooms during a time of a group's meeting will likely:

- Upset the group's leadership, because it will appear to the group's members that its leaders were poor negotiators who were "outsmarted" by the hotel.
- Upset the hotel's sales representative responsible for servicing the group, because rather than appearing to have given the group a "good rate," the hotel's sales representative will now appear to have taken advantage of the group. The result is a loss of credibility on the part of the sales representative and the hotel.
- Create hard feelings and accounting difficulties as meeting planners attempt to receive the concession or "comp" terms promised in their group lodging contracts. These difficulties arise because, in many cases, a group's members will in fact have purchased the total number of room nights the group contracted to buy. However, because the hotel's yield management decisions drove attendees away from the group block (but not away from the hotel) the attendees' room night purchases were not counted as part of the group block pick-up.

The language utilized in developing conference services contracts is among some of the most complex and rapidly changing in the hospitality industry. This is so because meeting planners representing group space and sleeping room buyers are sophisticated professionals, as are their hotel counterparts. As a hospitality manager, it is important to be aware of, and fully understand, the essential contract clauses currently used in conference services contracts. To learn more about these critically important clauses, follow the instructions found in Search the Web 5.5.

Search the Web 5.5

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6. Review this article, and be prepared to discuss it in class.

» ANALYZE THE SITUATION 5.2

MELISSA IS THE CONVENTION services director at her city's civic (convention) center. The center has been contracted to host a large press conference to announce the intention of the Republican senator representing her state to run for reelection. Despite Melissa's best efforts, the senator's office is very unhappy with the physical condition of the civic center.

"This is awful," says the senator's chief of staff. "The carpet is worn and the interiors need painting. This isn't how the center looked six years ago when we booked our reelection announcement speech. It's too

late to move the press conference now, but there is no way the senator is paying the contracted amount for this space. It's just six years after we selected you, and now the conditions are terrible!

Despite the fact that the civic center is, indeed, six years older than it was at the time of the contract signing, it is not materially different, and Melissa suspects that the complaint about the condition of the facilities is merely a ploy, initiated by the senator's chief of staff, to receive a reduction on the senator's conference services bill.

Assume that you are Melissa.

1. What would be your response to the senator's aide?
2. Assume that Melissa is responsible for drafting the contracts for all of the civic center's space requests that are to take place five or more years in the future. What would you do to ensure that guests such as these were not, in the future, able to make the claim that the facilities they contracted for previously were not the same as those they actually received on the date of their meeting?



INTERNATIONAL SNAPSHOT

*A Comparison of Franchise Disclosure Requirements under U.S. Law and International Law**

INTRODUCTION

Due to the widespread increase in franchising as a method of doing business, there has been a tremendous increase in franchise legislation both in the United States and internationally. Specifically, in addition to the United States, the following 12 countries have enacted franchise disclosure laws: (1) Australia; (2) Brazil; (3) Canada, Alberta Province; (4) Canada, Ontario Province; (5) China; (6) France; (7) Indonesia; (8) Malaysia; (9) Mexico; (10) Romania; (11) South Korea; and (12) Spain. Both the United States and the foreign jurisdictions regulate franchising and offer protections to prospective franchisees through presale disclosures, which take the form of a Uniform Franchise Offering Circular (UFOC) in the United States.

ITEMS TO BE DISCLOSED

The UFOC contains 23 broad categories of disclosure items. Of these items, the only ones that are either required or recommended to be disclosed in all of the foreign jurisdictions are the basic franchisor

information, ongoing fees, and investment costs. The other items of disclosure (i.e., franchisor management, bankruptcy, franchisor and franchisee obligations, exclusive territory, franchisor financing, franchisee outlets, and trademark information) are required only in some of the jurisdictions.

The second main difference between the United States and the foreign jurisdictions deals with public figures (persons whose names or physical appearance are generally known to the public in the geographic area where the franchise will be located). In the United States, information pertaining to public figures must be disclosed, whereas the foreign jurisdictions do not require such disclosure.

The third difference between U.S. and international disclosures deals with earnings information. Specifically, only Australia requires such disclosure, while Canada, France, and Romania recommend the disclosure of earnings information. Meanwhile, earnings information is a mandatory disclosure in the United States.

The fourth distinction involves the disclosure of the franchise agreement in the UFOC. In the United States, the franchise agreement must be included in the UFOC,

*Some of the factual information contained in this article was obtained from the following publication: Andrew P. Loewinger and Michael K. Lindsey, "International Franchise Disclosure Laws" (Conference Proceedings of the ABA Forum on Franchising, Scottsdale, Arizona, 2002).

whereas only six of the foreign countries require the franchise agreement to be disclosed.

The last major difference between the U.S. and foreign disclosure requirements centers on the franchisor's financial situation. In the United States, the franchisor's financial statements must be included in the UFOC. In contrast, only about two-thirds of the foreign jurisdictions require the franchisor's financial condition to be disclosed.

DISCLOSURE REQUIREMENTS IN CHINA

Franchising is still in its early stages in China. Currently, franchising is regulated through the "Trial Implementation Measures of the Administration of Franchise Operations" (the "Measures"), which were primarily established to standardize franchise operations and to protect the legal rights of the franchisor and franchisee.

Since franchising is not a predominant method of doing business in China, the disclosure requirements under Chinese law are minimal. Specifically, only the following items are either required or recommended to be disclosed in China:

Franchisor information
Initial fees

Ongoing fees

Investment information

Supplier information

Franchisor duties

Current and past franchisees

Financial statements

Receipt

None of the remaining items are required to be disclosed under Chinese law.

OTHER DIFFERENCES

These examples demonstrate just a few of the differences between United States and foreign jurisdictions with respect to presale disclosures. Other differences center on who is required to provide disclosures, who is required to receive disclosures, and when the disclosures are required. Further, there are differences between the U.S. and foreign laws as to the exemptions and exclusions under the franchise laws. In sum, before investing in a franchise, a potential franchisee should seek the advice of an experienced franchise attorney to review the franchisor's business and to prevent any overreaching by the franchisor.

Provided by Robert Zarco and Himanshu M. Patel of the law firm of Zarco Einhorn & Salkowski, P.A., Miami, Florida. www.zarcolaw.com.

WHAT WOULD YOU DO?

Assume that you are the group sales manager at the Claremont hotel. John Pingston is one of your clients. Mr. Pingston, a professional meeting planner, works for a meeting planning company that was selected by the American Society of Hospitality Teachers (ASHT) to choose a hotel for that society's annual meeting.

At your hotel, like many others, the purchase of all hotel room nights is accompanied by the awarding, to the buyer, of major airline frequent flier credits (points). Mr. Pingston agrees to select the Claremont for the ASHT meeting but then states that, as the person responsible for "buying" the rooms, the airline award miles that accompany the room sales should be granted to him personally rather than to the ASHT, and, in

fact, he strongly implies that if he is not granted the frequent traveler airline miles, he will move the contract for the group's 700 total room nights to one of the Claremont's competitors.

1. Would you grant the mileage award points to Mr. Pingston? Why or why not?
2. Assume that you granted the bonus miles to Mr. Pingston.
 - a. Who do you feel would be more embarrassed by the disclosure that you did so? The planner or your hotel?
 - b. If you decided to do so, to whom should you disclose Mr. Pingston's "booking bonuses"?
 - i. The CEO of the planner's company?
 - ii. The ASHT board of directors?
 - iii. The membership of the ASHT?

THE HOSPITALITY INDUSTRY IN COURT

The following two case studies involving hospitality firms revolve around the interpretation of contracts. First consider *Marriott Hotel Services, Inc. v. National Vacation Resorts*, 2008 WL 2690060 (Cal. App. 2008).

FACTUAL SUMMARY

National Vacation Resorts (Classics) entered into a group rooms contract with Marriott Hotel Services (Marriott). Marriott agreed to provide hotel rooms to Classics for a room commitment of 1,360 rooms over a course of several days in 2005. The contract included an Attrition clause stating that if less than 85 percent of the total room nights were used, then Classics would pay liquidated damages that totaled the difference between 85 percent of the total room nights and Classics' actual room usage, multiplied by the average room group rate. Preceding the Attrition clause, however, was a Group Room Rate clause that stated, "On or before December 22, 2004, Classics may release up to 25 rooms per night from the room block at no penalty. If Classics exercises this option, Marriott has the right to revoke the Marius Meeting Room for the purpose of booking an additional group. The following Attrition clause will then apply to the revised room block."

In July 2005, Marriott informed Classics that there was an outstanding balance on the contract, which included an \$81,030 charge for a shortfall of 370 rooms. Marriott demanded payment of the outstanding balance, and Classics asserted that the Attrition clause did not apply because it did not release the 25 rooms as stated in the group room rate clause.

ISSUE FOR THE COURT

The issue in this case was whether Classics' interpretation of the contract would apply, resulting in the application of the Group Room Rates clause being condition precedent to the application of the Attrition clause. Classics contended that the Attrition clause that Marriott sought shortfall damages under only applied to a revised room block. Specifically, Classics stated that under the Group Room Rates clause in the contract, which preceded the Attrition clause, the Room Attrition clause would only apply if Classics had released 25 rooms, and thus revised the room block. If Classics' interpretation was correct, then Classics would not be responsible for the outstanding balance on the contract because it had not released the 25 rooms, and thus the condition precedent to the Attrition clause had not occurred. If not, then Classics would be liable under the Attrition clause for the room shortfall by reading the contract in its entirety.

DECISION

The court disagreed with Classics' position, and relied on settled contract interpretation standards stating that Classics' interpretation of the contract was only relevant if the contractual language is reasonably susceptible to differing interpretations. In this case, Classics only offered a subjective interpretation of the contract that was not disclosed during negotiations, and thus did not constitute competent extrinsic evidence to support their interpretation. Thus, since the interpretation evidence was inadmissible, there was no conflict of interpretation regarding the Attrition clause. The court read the contract as a whole, and in its plain language, found that the purpose of the clauses was clear. Under the Group Room Rates clause, Classics was given an option to reduce the room number in the room block in order to minimize the financial impact of an anticipated shortfall. The Attrition clause would apply and functionally penalize Classics if the anticipated shortfall was more than 15 percent of the revised room block number. Thus, the Attrition clause was always effective, but Marriott had simply given Classics a 15 percent cushion that, if timely invoked, could lessen some of the burden of an anticipated shortfall.

MESSAGE TO MANAGEMENT

Be sure to clearly understand what each party expects from the clauses negotiated in a contract. If you are unsure, bring up your concerns during negotiations to clarify the contract language, because courts are extremely unwilling to rewrite a signed and negotiated contract that has objectively clear terms.

Second, consider *Hyatt Corp. v. Women's Int'l Bowling Cong., Inc.*, 80 F. Supp. 2d 88 (W.D.N.Y. 1999).

FACTUAL SUMMARY

The Women's International Bowling Congress (WIBC) made convention arrangements with the Hyatt Regency of Buffalo, New York (Hyatt). Under the agreement, Hyatt would hold a block of rooms for WIBC convention attendees. The convention attendees would be financially responsible for their own rooms. WIBC made a request to Hyatt for additional rooms to be held under the convention block. Hyatt agreed to hold the additional rooms, and attempted to insert clauses into the revised agreement requiring WIBC to guarantee all rooms would be filled and obligating WIBC to pay for any unused rooms. WIBC did not sign the revised agreement but instead offered a substitute agreement that made no mention of a guarantee to fill all rooms or an obligation to pay for unused rooms. The substitute agreement proposed by WIBC was signed by both parties and incorporated into the convention contract. The convention attendees used only about half of the rooms held by Hyatt. Hyatt sued WIBC to recover compensation for the unused rooms. WIBC refused to pay for the rooms and asserted it was never obligated to do so.

QUESTION FOR THE COURT

The question for the court was whether the contract obligated WIBC to pay for unused rooms held by Hyatt for the convention room block. The court was first faced with whether the contract was unclear. In deciding whether WIBC was obligated to pay for unused the rooms, the court would only look to the terms of the contract if the language was clear. No outside evidence could be presented by the parties unless the terms of the contract were unclear and additional explanation was needed. Hyatt argued it was reserving a block of rooms for WIBC. In using the term "reserve," Hyatt attempted to show WIBC meant to pay for unused rooms. However, the actual term used in the contract was "hold." WIBC argued the term "hold" made it clear no financial obligation was intended. Instead, the rooms were to be held by Hyatt for the individual convention attendees to reserve and pay for.

DECISION

The district court ruled in favor of WIBC. The court held the contract language was clear or unambiguous. It also held the use of the term "hold" meant WIBC was under no obligation to use all of the rooms in the room block or pay for unused rooms.

MESSAGE TO MANAGEMENT

The contracts must spell out clearly and unequivocally the intentions of the parties. Use illustrations, if need be, to clearly establish the scope of the agreement.

Although the content of any contract signed by a manager is important, in the hospitality industry, the wording found in some forms of hospitality-specific contracts is especially important. As a result, hospitality managers know that there are essential phrases (clauses) that their contracts should contain. This is true both for contracts relating to the goods and services hospitality managers provide to their guests and for the products and services they themselves purchase. Individuals who undertake

WHAT DID YOU
LEARN IN THIS
CHAPTER?

responsibility for signing contracts of these types must know and understand these clauses well.

Just as the wording found in some hospitality contracts is especially significant, some hospitality contracts types are especially important to managers. Franchise-related contracts are one type of agreement that is of special importance to hospitality managers. Critical components of these varied contracts can include very specific terms related to purchasing a franchise, operating a franchised business, and selling a franchise.

Management contracts, or management agreements, comprise another contractual area of special significance to hospitality managers. This is so because a great number of management companies operate hospitality businesses for these business's owners. As a result, the contracts between the owners of a business and those who manage it can take many forms. Often, these contracts are complex and very detailed. Because this is so, hospitality managers must pay very close attention to the conditions and terms of management agreements. This is especially the case when the management contract describes an agreement for operating an owner's franchised business.

Finally, in the segment of the hospitality industry that routinely rents meeting space or sleeping rooms to guests, there are additional contract features that are unique. Meeting and space contracts, as well as group lodging contracts, are especially significant contract types encountered by many hospitality managers.

RAPID REVIEW

After you have studied this chapter, you should be prepared to:

1. List and describe those clauses essential to contracts utilized when providing products and services to guests.
2. List and describe those clauses essential to contracts utilized when purchasing hospitality products and services.
3. Explain to potential buyers of a franchise the importance of the Franchise Rule.
4. List three advantages and three disadvantages to operating a business under a franchise agreement.
5. Explain the various arrangements under which management companies operate businesses.
6. Identify potential sources of conflict you might face if, for its owner, you operated, under a management contract, a franchised business such as a restaurant, hotel, or car rental facility.
7. Identify at least three essential contract clauses that protect a hotel when contracting to provide space and food products for a large wedding party.
8. Log on to the Hospitalitylawyer.com "Best in Class" segment identified in Search the Web 5.5. When you arrive, review the terms required for ADA compliance. List the responsibilities of meeting planners, as well as the meeting venue they select, for ensuring conformity with its basic provisions.

TEAM ACTIVITY

With your team, obtain a copy of a group meeting and space contract from a hotel in your area. Identify the following clauses in the contract:

- Indemnification
- Oral modification
- Acts of nature
- Guarantees (attrition)

Changes, additions, and modifications

Liquor liability

Americans with Disabilities Act (ADA)

Ownership

Duty to mitigate damages

Termination

Construction and remodeling

Service fees versus gratuities

If you cannot find one or more of these clauses, is the contract deficient? Why or why not?