When Can a Hotel Owner Terminate the Hotel Management Agreement? A UAE Law Perspective

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In order to ensure that whatever is provided in the HMA as a ground for unilateral termination by the Owner is enforceable under UAE law, thorough consideration should be given at the outset of negotiations of the HMA.

This article examines the options available to an Owner to terminate the HMA prematurely, where the HMA is governed by UAE law.

Unilateral termination in the event of Operator breach

Once the Owner signs the HMA with the Operator it should take into account that, generally, proving an Operator's breach of its contractual obligations will in practice be extremely difficult. One of the main reasons for this is due to the fact that the Operator's management and operation of the hotel is undertaken through the Hotel personnel who, in the UAE, are employees of the Owner. Therefore, omissions on the part of Hotel staff, from a legal perspective, may be held as omissions of the Owner's employees and not the Operator (unless it can be proven that the Operator was aware of such omissions and didn't prevent them when it had the possibility to do so). This scenario may be altered in favour of an Owner should the Owner and Operator agree that the key personnel of the Hotel (i.e. the general manager, financial controller, head of marketing etc.) will be employed by the Operator and seconded to the Owner. This may, in certain circumstances, assist the Owner's proof of a breach by the Operator's (rather than the Owner's) staff under the HMA. Therefore, it is preferable for an Owner to require such arrangements at the outset of negotiation of the HMA.

Assuming that the Operator's breach of the HMA can be proven by the Owner, the Owner can terminate the HMA in compliance with the UAE Civil Code by way of the parties' mutual consent, by operation of law and by way of a court order. In order to avoid lengthy litigation/arbitration proceedings to secure a court order, the Owner may wish to rely on Article 271 of UAE Civil Code, which provides for a special method of termination:

"It shall be permissible to agree that a contract shall be regarded as being cancelled spontaneously [automatically] without the need for a judicial order upon non-performance of the obligations arising thereout, and such agreement shall not dispense with notice unless the contracting parties have expressly agreed that it should be dispensed with."

This Article permits that the wording of a termination clause in the HMA can prevail over (i) the need for a court order and (ii) the need for notice to be given to terminate. The position of the Dubai courts in previous rulings has confirmed that where the parties have expressly agreed in the contract to vest either party with a right to terminate the contract upon the breach of the other party, such provision is

enforceable provided that the contract clearly states that such right can be exercised without the need for a court order (e.g. Court of Cassation judgment No. 266/2005). The Owner will however need to ensure at the outset of negotiation of the HMA that supporting language to this effect is included in the HMA.

On the other hand, the Owner should be mindful that there should be enough evidence of the Operator's breach to substantiate the termination. Otherwise, if the Operator disputes the termination of the HMA by the Owner in court or arbitration and succeeds in showing that the termination was wrongful, the Operator will be entitled to claim damages from the Owner for breach of contract.

Unilateral termination for convenience (no default on the part of the Operator)

As was mentioned above, the general rule under the UAE Civil Code provides that if there is no mutual consent between the parties to terminate a contract, neither party can unilaterally terminate it in the absence of a default allowing such termination.

But does UAE law allow the parties to agree that one party can terminate unilaterally for convenience (i.e. that the Owner can terminate even if there is no default on the part of the Operator)?

Yes, if the parties have agreed in the HMA that it can be unilaterally terminated (in the absence of either party's default) by the Owner without the need for a court order, this will be upheld pursuant to the UAE Civil Code (Article 218) and court practice. However, an Operator will usually not agree to grant an Owner such a right in the HMA without a term that compensation (liquidated damages) be paid by the Owner to the Operator in the event such right is exercised. The Operator would require that the amount of such compensation be included in the HMA.

With respect to the amount of any such compensation, the right of the parties to agree in advance is generally provided for in Article 390 of the UAE Civil Code. The UAE courts have traditionally been of the opinion that liquidated damages cannot be awarded upon termination of a contract due to the fact that the agreement on liquidated damages within the contract is an ancillary (supporting) obligation, and therefore, does not exist in isolation of the primary obligation. As a result, until recently UAE courts have consistently applied the rule that where the primary obligation is terminated, the liquidated damages clause shall be disregarded as well. However, this position was recently changed by a ruling of Abu Dhabi Court of Cassation (Commercial Appeal No. 790-2013, dated 22. October 2014):

"A penalty clause, being liquidated damages, is ancillary to a principal obligation. When the principal obligation is extinguished by the termination of the contract, the ancillary obligation is likewise extinguished and deprived of its effect. Thus, any tenable action for termination cannot be brought in contract and must be brought in tort in accordance with the general rules given that the penalty clause relates to the obligations imposed in contract upon its parties and calls for a penalty in the event of breach while the contract is still in force. ***However, if the penalty clause is independent and unrelated to any of the obligations, the extinguishment of the contract would have no effect on the existence of the penalty clause insofar as it gives rise to a separate agreement between the parties, notwithstanding its inclusion in the contract itself."***

However, there is no such case law yet established in other Emirates, which means that should the Operator challenge the validity of the provision in the HMA on the pre-agreed amount of liquidated damages, there is a potential risk that the court (of an Emirate other than Abu Dhabi) or arbitral tribunal may interpret the nature of the liquidated damages differently, i.e. by considering that the liquidated damages clause has been terminated simultaneously with the termination of the HMA. Should this be the case, the court would then be entitled to assess the damages in accordance with the general rules for damage assessment, and not the pre-agreed amount of liquidated damages. In this case, both parties bear the risk of such assessment being unpredictable. However, the good news for an Owner is that in this case, the burden of proof with respect to the amount of incurred damages would be on the Operator.

The parties should also appreciate that the amount of compensation (liquidated damages), despite being

specified in the HMA, may be varied by the court even if it finds that it survives the termination of the main agreement. On the application of either party the court has the discretion under Article 390(2) of the UAE Civil Code to vary the agreement as to the amount of compensation to be awarded, so as to make the compensation equal to the loss and any agreement of the parties to the contrary in the HMA in such circumstances, would be null and void. This practically means that either party could claim for an increase or decrease of the pre-agreed amount of compensation, however, the party bringing such a claim will have the burden of proof in court to override the pre-agreed amount of liquidated damages under the HMA.

Therefore, should an Owner wish to negotiate termination for convenience in the HMA, the Owner should be mindful that Operators are usually reluctant to agree and so it should be raised at the outset of negotiations. Such a right to terminate is particularly important for an Owner where the nature of the performance test in the HMA will severely restrict the Owner's other rights of termination.

Unilateral termination in case of failure of performance test

A common contractual ground for termination by the Owner is where the Operator fails the performance test. For the majority of HMAs, the ability to terminate for failure of the performance test will effectively be the only way for an Owner to terminate the HMA without risk of payment of liquidated damages to the Operator. Therefore, the importance of the structuring of the performance test cannot be overestimated.

However, the mere existence of a performance test in the HMA is not a guarantee of protection for the Owner, and so the negotiation of a fair, effective and representative performance test in the HMA should be a key issue for an Owner at the outset of negotiation of the HMA. There are numerous options for structuring a performance test, and these will to a large extent depend on various circumstances and scenarios of the project and both the Owner's and the Operator's positions in negotiation. Where an effective performance test is not possible, then an Owner may wish to focus on a right of unilateral termination for convenience instead, with payment of compensation to the Operator.

Conclusion

Whilst the Owner will hope never to have to terminate the Operator before the end of the contract term, it is important that the Owner negotiates contractual rights of termination to ensure that the Owner has the right to efficiently replace the Operator. It is essential that proper wording is used and that specialist legal advice is sought prior to the HMA being signed.