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Brand Rights and Hotel Management Agreements: Lessons from Ritz-Carlton Bali's Lawsuit against the Ritz-Carlton Hotel Company

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Abstract
In this article, the authors consider the managerial implications of a recent lawsuit, P. T. Karang Mas Sejahtera v. The Ritz-Carlton Hotel Company, LLC, in which a jury found for the plaintiff, the owner of the Ritz-Carlton Bali Resort and Spa, against the defendant, The Ritz-Carlton Hotel Company, LLC. Ritz-Carlton's parent company, Marriott International, had previously formed a partnership with Bulgari S.p.A., the Italian luxury jewelry and accessories firm, to create Bulgari Hotels and Resorts, a new ultraexclusive line of luxury hotels. The first two Bulgari properties opened in Milan and Bali. Soon after the Bali project was announced, P. T. Karang Mas Sejahtera (KMS) sued Ritz-Carlton for breach of agreement. The authors show that this and other recent court decisions situate hotel management agreements squarely under agency law. Within the framework of agency law, an agent owes specific fiduciary duties to a principal that supersede contractual terms and a principal has a nearly absolute right to terminate such a agreement. In the Bali case, the violated duties included a duty not to compete with or assist the competitors of a property being managed under agreements within that property's competitive market set. The authors argue that, as a consequence of these legal decisions, issues pertaining to brand rights and management agreements have been clarified. In this article, the authors outline these brand rights issues, review these precedent-setting legal cases, explain why Ritz-Carlton lost the suit to KMS, and draw several lessons pertaining to hotel management.

Keywords
brand rights, hotel management agreements, hotel brand licensing, hotel litigation, international hotels, Marriott, Ritz-Carlton, Bugari, Bali

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by CHEKITAN S. DEV, JOHN H. THOMAS, JOHN BUSCHMAN, and ERIC ANDERSON

In this article, the authors consider the managerial implications of a recent lawsuit, *P. T. Karang Mas Sejahtera v. The Ritz-Carlton Hotel Company, LLC*, in which a jury found for the plaintiff, the owner of the Ritz-Carlton Bali Resort and Spa, against the defendant, The Ritz-Carlton Hotel Company, LLC. Ritz-Carlton's parent company, Marriott International, had previously formed a partnership with Bulgari S.p.A., the Italian luxury jewelry and accessories firm, to create Bulgari Hotels and Resorts, a new ultraexclusive line of luxury hotels. The first two Bulgari properties opened in Milan and Bali. Soon after the Bali project was announced, P. T. Karang Mas Sejahtera (KMS) sued Ritz-Carlton for breach of agreement. The authors show that this and other recent court decisions situate hotel management agreements squarely under agency law. Within the framework of agency law, an agent owes specific fiduciary duties to a principal that supersede contractual terms and a principal has a nearly absolute right to terminate such a agreement. In the Bali case, the violated duties included a duty not to compete with or assist the competitors of a property being managed under agreements within that property's competitive market set. The authors argue that, as a consequence of these legal decisions, issues pertaining to brand rights and management agreements have been clarified. In this article, the authors outline these brand rights issues, review these precedent-setting legal cases, explain why Ritz-Carlton lost the suit to KMS, and draw several lessons pertaining to hotel management.

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The business model under which many hotels operate, in which a property owner uses a management agreement to engage a hotel firm to run its facility, has not always worked smoothly because of the complexities involved in the use by the property of the firm's resources and brand name. Complications arise, for example, in the context of a management firm's often worldwide marketing strategies, in pursuit of which a large firm spans the globe as it jockeys for market share with other major hospitality firms. In this high-stakes game, firms try to play off consumer trends in both traditional and newer markets, hoping to capitalize on the latest preferences and appetites for locations, facilities, and amenities. Since the early 1990s, however, a series of court cases in which property owners have litigated to protect their interests have gradually clarified the legal obligations that a hotel property manager incurs upon entering such a agreement.

The hotel management agreement is ideally beneficial for both the property owner and the operating management company. The owner benefits from the value added to the property by the prestige, marketing skill, and good management of the operator. The operator has a profitable revenue source from a property in which the capitalization is provided by the owner. Tensions arise between the owner and the operator when there are perceived conflicts of interest, as in the instant case, or when the operator desires to maintain standards for the brand (higher operating costs) while the owner would prefer to decrease operating costs to increase the bottom line. It is when such tensions arise that the details of the hotel management agreement terms become important.

We argue that, as confirmed by four major legal cases that played out over the 1990s as well as a recently adjudicated case, hotel companies should view their relationships with property owners with whom they agreement to manage properties as a form of agency, and indeed in legal terms the cumulative effect of the cases in question has been to remove any doubt that hotel management agreements fall under agency law. In such a legal framework, a management agreement applies within a set of constraints that can supersede the terms of a given agreement because the law recognizes specific fiduciary and other rights that pertain to any entity that hires an agent to represent its interests. In this article, we summarize several issues involving brand rights that are affected by these legal outcomes, briefly review the 1990s cases to set the stage for the most recent one, describe the situation that unfolded recently on the island of Bali involving the Marriott Corporation's Ritz-Carlton unit and a venture into the hotel business by the high-end Italian jewelry brand Bulgari S.p.A, and consider the implications of all these developments for brand rights in management agreements.

The case in question is titled *P.T. Karang Mas Sejahtera v. The Ritz-Carlton Hotel Company, LLC* (Civil Action No.: 8:05-cv-00787-PJM).[1] P.T. Karang Mas Sejahtera (KMS) was the owner of the Ritz-Carlton Bali Resort & Spa, a luxury property managed by Ritz-Carlton. Ritz-Carlton is a subsidiary of Marriott International, Inc. In the case in question, KMS sued Marriott and Ritz-Carlton because the latter, in partnership with Bulgari, opened a luxury resort and spa in Bali, the same market in which

1. Hereafter we shall refer to this case as *KMS v. Ritz-Carlton*.
2. Marriott International, Inc., originally a defendant in the lawsuit, was voluntarily dismissed by KMS at trial.

KMS operates the Ritz-Carlton Bali.[2] KMS claimed that this action violated its management agreement with Ritz-Carlton; the outcome of the case affirmed this claim and was another instance in which the courts have applied agency law to disputes involving management agreements. We argue that, while some questions pertaining to management agreements and the relevant rights of property owners and hotel firms may remain open, the disposition of the case involving KMS, Ritz-Carlton, and Bulgari has clarified these issues to a considerable extent. Before we take up the case itself, however, we must consider brand and brand rights issues in greater detail, because the dispute over the noncompetition clause in effect turned on the question of whether it was a violation of KMS's exclusive right to use the Ritz-Carlton brand on its property and in its marketing efforts on the island of Bali.

Brand Relationships Involved in *KMS v. Ritz-Carlton*

The American Marketing Association defines a "brand" as "a name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers."[3] More technically, a brand is a trademark or, when the brand applies to an entire firm, a trade name. Practically, however, a brand is an "intangible" or abstract concept in the minds of consumers, carrying with it any number of implications for consumer buying decisions (Keller 2008, 10). From a marketing standpoint, the purpose of a brand is to attract consumers to buy a good or service by associating that good or service in the mind of a consumer with an expectation that the good or service will satisfy the consumer's purpose in entering a particular marketplace.

There are more than 230 hotel brands in the United States and nearly 330 worldwide. There are not, of course, this many hotel *companies*—through the strategies of *brand extension* and *cobranding*, many hotel brands are operated by the major hotel companies. Marriott, for example, includes several brands among its subsidiaries, including such familiar names as Courtyard by Marriott, Renaissance Hotels & Resorts, Fairfield Inns by Marriott, and of course the brand that interests us here, Ritz-Carlton. To this list we should add Bulgari Hotels and Resorts, which is affiliated with Marriott through its cobranding partnership with Ritz-Carlton. The association of the Bulgari brand with that of Marriott is clearly expressed in Marriott's 2006 Annual Report:

> Bulgari Hotels & Resorts®, developed in partnership with jeweler and luxury goods designer Bulgari SpA, is a collection of sophisticated, intimate luxury properties located in exclusive destinations. Properties feature Bulgari's striking contemporary interpretation of luxury design and cuisine. The Bulgari Resort Bali opened fall 2006 with 59 private villas, two restaurants, and comprehensive spa facilities in a spectacular sea-view setting. (Marriott International 2006, 3)

What is not shown in this report is the association between Ritz-Carlton and Bulgari that forms the basis of the lawsuit. We shall see, however, that Marriott did publicize this relationship sufficiently to establish in the courts the proposition that the Bulgari Bali involves a cobranding partnership between Bulgari and Ritz-Carlton that violated the brand rights of the Ritz-Carlton Bali. In the next section, we discuss these brand rights.

Ritz-Carlton Brand Rights

It is often difficult in recent times to keep abreast of changes in brand names, as

3. From the dictionary posted on the American Marketing Association website, http://www.marketingpower.com/_layouts/Dictionary.aspx?dLetter=B (accessed January 28, 2009).

company buyouts and mergers often involve brand rights. That is, when one company buys another company that has a recognizable brand name, the buying company often will also purchase the right to use that brand name in marketing its own products as well as those that had previously worn the brand name. To convey a sense of the significance of brand rights, it suffices to consider the history of the Ritz-Carlton name. In 1964, when Gerald F. Blakely Jr. and associates acquired the Ritz-Carlton Boston, it was the only property in the United States with that name. Later, the Blakely group acquired the rights to use the name “Ritz-Carlton” everywhere in North America except Chicago and Montreal. Brand rights, then, can be highly specific. In 1978, Blakely sought and was awarded the U.S. trademark rights to the Ritz-Carlton name. These rights were then conveyed to Johnson Properties, which purchased Ritz-Carlton in 1983. Johnson had acquired the worldwide rights to the name by 1988 (excepting Paris, Montreal, and Madrid, as well as all of Portugal and the United Kingdom). Marriott International purchased a 49 percent share in the Ritz-Carlton brand in 1995, eventually increasing that share to 99 percent in 1998 for $290 million. So when Ritz-Carlton arranged to help develop, market, and manage the new Bulgari Hotels and Resorts properties, Marriott found itself (initially) as the primary defendant in the KMS suit. In purchasing the right to use the Ritz-Carlton brand, Marriott also assumed responsibility for the consequences of its use.

Hotel management agreements typically involve brand rights because hotel property owners engage with hotel management companies like Ritz-Carlton to benefit from the name recognition and favorable brand image that accompany such a name. The brand rights in such a case typically remain in force for the duration of the agreement and, perhaps more importantly for our purposes, apply to some specified territory, within which the management firm or agent may not operate a comparable property under the same brand name. This has been expressed in the literature as the right to a reasonable, restrictive (non-compete) covenant. Such a covenant expressly acknowledges a right against competition that arises automatically under agency law. According to industry experts,

> It is increasingly difficult for owners to ensure that their hotel is the sole beneficiary of a brand’s strength in a particular market; careful consideration should be given to negotiating an exclusive trade area and the term or duration of the non-compete clause. Specific attention should be given to defining similar or “sister” brands under the same corporate management (e.g., Marriott full-service hotels and Renaissance, Sheraton, and Westin), as well as to crafting carefully the legal language surrounding this provision (e.g., specifying the use of impact studies to determine infringement on a trade area). (Crandell, Dickinson, and Kanter 2003, p. 101)

Brand rights issues—as indicated here—can be complicated by the many and frequent corporate mergers and buyouts that occur in the hotel industry. Many branded hotels belong to a larger corporate structure, and such arrangements are sometimes indicated by brand names, as in the case of Sheraton or Westin. There are, however, cases in which the parent company’s brand name is deliberately excluded from a property’s marketing efforts. This appears to be so with the Ritz-Carlton’s inclusion in the Marriott’s large family of brands.

It is likely that guests of Ritz-Carlton hotels do not see the Marriott name prominently displayed at a given property because the Ritz-Carlton name is associated with a particularly high level of luxury and personal service that distinguishes it from all other

Marriott brands. If consumers seeking the specific qualities that they associate with the Ritz-Carlton name were to see that name explicitly associated with Marriott—with "Marriott Ritz-Carlton" emblazoned all over the properties, for example—they might assume that the level of luxury that they had associated with Ritz-Carlton was now compromised. This would be a classic case of brand dilution. (To avoid this, when Marriott bought Ritz-Carlton, it made the latter a separate strategic business unit within the Marriott corporate structure, complete with its own central reservations system.) Brand dilution occurs in other circumstances as well, however, which explains the contractual interest expressed by property owners in restricting same-brand competition within a given territory through a "radius clause." When nearby properties operate under the same brand name, they could "thin" the brand equity the name represents, preventing either property from realizing the full potential of the brand to generate revenue in that market. This could result in brand dilution. It may not affect the parent brand's business, but it can adversely affect the profitability of individual property owners:

> Although it is seemingly logical that the operator, as the owner's agent, should work to advance only ownership's interests, an inherent conflict exists between building brand equity and owner's equity. Oftentimes the operator's decisions benefit the brand but do not necessarily add asset value—and, in some instances, may detract from the value of the hotel asset. (Crandell, Dickinson, and Kanter 2003, p. 99)

Branded hotel operating companies by their very nature seek growth, which means situating as many properties as possible in as many markets as possible. Yet the interests of an operating company with several brands in the fold could conflict with those of a property owner. If the managers attempt to move multiple brands into a given market, and when the brands are positioned differently, that may well produce no detrimental effects on individual properties under the same brand umbrella. After all, there is little resemblance between, say, a Ritz-Carlton and a Fairfield Inn. Even within a given geographical territory, they are going to appeal to different market segments. But the potential for conflict by introducing multiple brands within one market is obvious (for more on this topic, see McCarthy and Raleigh 2004).

When Marriott International completed its purchase of The Ritz-Carlton Hotel Company in 1999, it had set the crown jewel in its brand portfolio. Johnson Properties had already expanded the brand significantly by that time, and the Ritz-Carlton Bali Resort and Spa, owned by KMS, an Indonesian hotel company, has been widely regarded as one of the world's premier luxury resorts since it opened for business in 1996 (the project was initiated in 1991). Combining a hotel of 368 guest rooms with 78 villas, including 38 new cliff villas offering breathtaking ocean views, the property offers twelve restaurants and lounges; luxury amenities such as putting golf, tennis, an outdoor pool, and an indoor thalasso pool that is part of an elaborate spa; and access to secluded Kubu Beach. It has consistently achieved high rankings by worldwide standards.[4] Its presence in Bali has helped to elevate that market into one of the top luxury tropical destinations in the world. Among its chief brand competitors in that market are Four Seasons, Aman, and Banyan Tree.

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4. Among these rankings are *Travel and Leisure*'s 2004 World's Best Awards, 24th (August 2004); *Condé Nast Traveler*'s Top 100, The Best in the World, 18th (November 2004); and Spa Asia 45 Spa Asia Crystal Awards, 2nd (December 2001).

Thus, when Marriott opened the Bulgari Bali with help from Ritz-Carlton, it was apparently in violation of the agreement by virtue of which Marriott, through Ritz-Carlton, managed the Ritz-Carlton Bali, owned by KMS, even though the new property did not bear the Ritz-Carlton name. Was this a form of brand dilution? It would appear so if it is a case of brand confusion, a specific form of brand dilution, protection against which is provided by the Trademark Dilution Revision Act of 2006.[5]

Brand confusion occurs when the same brand operates two properties in a given market. Whether that occurred as a result of the opening of the Bulgari Bali depends on the precise nature of the relationship between Bulgari Hotels and Resorts and The Ritz-Carlton Company, LLC, and on the manner in which this relationship was used in the launch and operation of the Bulgari Bali. This is because the effects of brand confusion in this case apply only to the Bali market. As we have noted, this cobranding venture would likely increase both Ritz-Carlton's and Bulgari's brand equity. There would be no brand confusion at the international level between Ritz-Carlton and Bulgari, because they represent distinct industries, albeit Bulgari was now entering the world of lodging. At the same time, however, in the Bali market, it would dilute the Ritz-Carlton Bali's brand, the equity from which KMS had contracted with Ritz-Carlton to enjoy. The brand confusion would come into play at that local market level, as potential customers would choose between the Ritz-Carlton Bali and the Bulgari Bali.

Brand Management Issues Pertaining to *KMS v. Ritz-Carlton*

We have mentioned the practice of brand extension in noting the many brands that are typically managed by major hotel companies. The creation of the Bulgari Hotels and Resorts brand is an example of such a practice, extending both the Bulgari brand (into the hotel business) and the Ritz-Carlton brand (into a new line of luxury properties), but this is the most general characterization of what has taken place. From a marketing standpoint, brand management strategies on the part of one entity may adversely affect the market position of other entities, a phenomenon sometimes known as brand dilution. Whether this is a case of brand dilution depends crucially on the relationship between Ritz-Carlton and Bulgari in the Bali market, where it affects the Ritz-Carlton Bali. We argue that, whether or not it is brand dilution in that market, the relationship more broadly is a case of cobranding. Cobranding occurs when two "parent" brands join forces in some way to enhance the images of both brands. That is, consumers who respect both of the brand names involved in a cobranding venture should find the combination of brands even more attractive than either by itself—or at least find that the combination in a particular local market elevates the attractiveness of a given property relative to that of its local competitors. If this is true, the strategy of bringing in Ritz-Carlton to help develop, market, and manage the Bulgari hotels should benefit both companies.

We argue here that the relationship between Ritz-Carlton and Bulgari Hotels is an instance of cobranding because it is a marriage of Ritz-Carlton's expertise in the development, marketing, and management of luxury hotel properties with Bulgari's expertise in design and luxury product marketing. Furthermore, we suggest that it was undertaken for conventional branding purposes—to create a market position and grow market share. Bulgari provides the design features of its hotel properties while

5. 15 U.S.C.A. s. 1051 *et seq*.

Ritz-Carlton provides the approach to managing the facilities and molding the personnel and services into a set of viable offerings that suggest to the consumer that to stay at a Bulgari hotel is to experience the ultimate in luxurious, personalized service and amenities. The goal of achieving this elevated level of product luxury was the business driver that led to the partnership between Ritz-Carlton and Bulgari.

The problem in the Bali case was that there was already a Ritz-Carlton in Bali. Even if the cobranding of Ritz-Carlton and Bulgari enhances the brand value or image of both of those firms and as a consequence creates considerable brand equity in their Bali property, that effect posed a threat to the Ritz-Carlton Bali owned by KMS, which, however strong its reputation (and it was strong indeed, as evidenced by its top ranking in leading international travel magazines such as *Travel & Leisure*), would now face a competitor in its local market that was benefiting from cobranding. To be sure, the name "Ritz-Carlton" rarely occurs in the consumer-facing communications or facilities of Bulgari Hotels and Resorts (although the initial marketing campaigns of Marriott, Ritz-Carlton, and Bulgari prominently featured the role of Ritz-Carlton). There are good reasons, however, to consider this relationship an example of cobranding, and if it is an example of cobranding, there are in turn good reasons to argue that the brand equity that the Ritz-Carlton Bali enjoyed through its relationship with Ritz-Carlton would be diluted by the presence of the Bulgari Bali. We shall return to these issues after we discuss some of the details of *KMS v. Ritz-Carlton*. To set the stage for that review, we examine four earlier cases that centered on the legal status of hotel management agreements.

Four Legal Cases Involving Hotel Management agreements

Our earlier claim that management agreements have come to be viewed by the courts as instruments governed by agency law is based on several court decisions, the most important of which were *Robert E. Woolley et al. v. Embassy Suites, Inc. et al*. (1991); *Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc*. (1993); *Government Guarantee Fund of the Republic of Finland v. Hyatt Corporation* (1996, 1998); and *2660 Woodley Road Joint Venture v. ITT Sheraton Corporation* (1998, 1999). These cases have had the cumulative effect, reflected in the disposition of *KMS v. Ritz-Carlton*, of clarifying (and apparently restricting) the rights of companies operating hotel properties under management agreements. To understand how this has affected the legal framework within which management agreements operate, we must briefly review some main principles involved in agency law.

According to the Legal Information Institute of the Cornell University Law School,

> Agency law is concerned with any "principal"-"agent" relationship; a relationship in which one person has legal authority to act for another. Such relationships arise from explicit appointment, or by implication. . . . The law of agency is based on the Latin maxim "*Qui facit per alium, facit per se*," which means "he who acts through another is deemed in law to do it himself." Agency, in its legal sense, nearly always relates to commercial or contractual dealings.[6]

Anything an agent does on behalf of a principal—the person or other entity that has authorized the agent—is legally an action

6. Quoted from the Legal Information Institute website, http://topics.law.cornell.edu/wex/agency (accessed January 28, 2009).

for which the principal can be held responsible. The courts have interpreted this through agency law to mean also that the agent bears certain common-law or fiduciary duties to the principal to ensure that the principal's interests are protected and promoted through the agent-principal relationship.

The recognition by the courts of specific fiduciary duties under agency law establishes a set of principles that can supersede the specific terms of an individual agreement. They are duties that apply in addition to and even in spite of any explicit contractual obligations (Wilson 2001, 12, 47). In other words, independently of the express terms of a written agreement, agency law imposes implicit duties that apply regardless of the content of the express terms of such an agreement. Such duties were set forth in the Restatement (Second) of the Law of Agency (1958). In accordance with these duties, an agent must, among other things, always act in the best interest of the principal, be loyal to the principal, maintain good faith in dealing with the principal, provide to the principal full disclosure of all activities, and provide to the principal a complete rendering of accounts. In general, agency law requires the agent to obey the principal's directives. The framework established by these obligations has been interpreted more recently, in the Restatement (Third) of the Law of Agency (2005), to include a "duty to refrain from competing with the principal and from taking action on behalf of or otherwise assisting the principal's competitors."[7] This last duty, it seems clear, forms the basis of the case made by KMS against Ritz-Carlton in the circumstances of the Bulgari Bali.

Let us now briefly consider the four precedent-setting cases that set the stage for KMS's suit against Ritz-Carlton. In the first two cases, the property owners had terminated their management agreements; the hotel management firms then challenged the terminations in court by asserting that the management agreements by their terms were irrevocable. In the earliest case, *Robert E. Woolley et al. v. Embassy Suites, Inc. et al.*, the 1991 ruling in favor of the owner was based on the principle that "any provision in the hotel management agreement attempting to restrict owners' powers to terminate manager would be ineffective in light of the owners' absolute power, as principals, to revoke agency even if characterized as irrevocable."[8] The common law of agency, which allows the principal to revoke the power of its agent, superseded the management agreement terms, which stated that the agreement was irrevocable.

The next case, which came to trial in 1993, closely followed the reasoning from *Woolley v. Embassy Suites*. The ruling in *Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc*. again came down in favor of the hotel owner, with the court finding that the "management firm did not have agency coupled with interest so as to preclude owner from exercising power to terminate agency."[9]

The principle was reiterated that, unless the hotel manager had an "agency coupled with an interest" by a share in the hotel ownership, the owner had an absolute right to terminate the agreement at any time despite contrary language in the management agreement. The hotel manager was an agent whose benefits were the management fees and incentives provided by the agreement. The remedies of the manager were to claim for damages from breach of the management agreement, but the agency

7. American Law Institute, Restatement (Third) of the Law of Agency (2005), §3.12 at 248, 253.
8. *Robert E. Woolley et al. v. Embassy Suites, Inc. et al*., 227 Cal. App. 3d 1520, 278 Cal. Rptr. 719 (1st DCA Cal. 1991).
9. *Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc*., 19 Cal.App.4th 615, 23 Cal.Rptr. 2d 555 (3rd DCA Cal. 1993).

relationship was terminable at will by the owner.

The circumstances of the third case, *Government Guarantee Fund v. Hyatt Corporation* (1996, 1998), were more complex. The Government Guarantee Fund of the government of Finland had stepped in to secure a failing bank that had foreclosed on a mortgage taken out by the owner of a hotel that had hired Hyatt as its management firm. Government Guarantee then sold the property to a Finnish government–owned holding company, 35 Acres. That company terminated the agreement with Hyatt almost immediately. Hyatt, refusing to vacate the premises, found itself in court, which ruled in favor of the new owner on the basis of the 1958 Restatement on Agency.[10] Again, the hotel owner's right to revoke the management agreement with Hyatt was validated, despite contrary agreement language.

The fourth case, *2660 Woodley Road v. ITT Sheraton Corporation* (1998, 1999), was still more complex, due to joint ownership issues and the creation of a separate corporation to represent the owner's interests. Again, however, the courts applied agency law and ruled in favor of the owner. Finding no coupled interest in the management agreement with Sheraton, the court held that the latter's role as agent was revocable.[11]

What makes the *Woodley* case more interesting in connection with the outcome of *KMS v. Ritz-Carlton* is that it was the first such case in which a jury was able to scrutinize the accounting books reflecting the hotel's operations in light of the fiduciary duties implied by agency law. As a result the jury awarded damages to the plaintiffs, three-quarters of which were punitive damages. Although the damages were later reduced on appeal in 2004,[12] a precedent had been set for considering the fiduciary relationship of agency in a hotel management context.

We now summarize the implications of these four cases in which agency law has been consistently applied to the termination of hotel management agreements. The cumulative effect of these decisions has been to change the landscape on which property owners and hotel management companies approach their contractual obligations. Even though the decisions strictly speaking did not create new rules governing such agreements, it has been observed that "none of the foregoing rules [of agency] was commonly understood or even recognized by hotel owners and operators prior to the early 1990s. Today, however, those rules influence the manner in which hotel owners and operators negotiate and draft their management agreements . . ." (Renard and Motley 2003, p. 59). The most important implications of the cases for hotel owner-manager relationships are as follows:

- Hotel management agreements fall under agency law.
- Agency law confers fiduciary duties upon hotel managers under agreement that supersede the specific terms of such a agreement, even when those terms seem to contradict such duties.
- Under agency law, owners have the right to terminate agreements at any time, regardless of contractual terms, unless the agency granted in the agreement is "coupled with an interest."
- It is difficult to prove such an interest, even where its existence is stated expressly in a management agreement; and it cannot include "management fees, protected trademarks and trade

10. *Government Guarantee Fund of Finland v. Hyatt Corporation*, 95 F.3d 291 (3d Cir. 1996).
11. *2660 Woodley Road v. ITT Sheraton Corporation et al.*, 1998 WL 1469541 (D.Del. 1998).
12. *2660 Woodley Road v. ITT Sheraton Corporation et al.*, 369 F. 3d 732 (3rd Cir. Del. 2004).

names, proprietary chain services, [or] management expertise" (Renard and Motley 2003, 69).

- An owner's termination of a agreement can be voided only if it is shown to be wrongful, which requires demonstration that the power of agency is coupled with an interest.
- A hotel manager may be required to open its accounting books and disclose its operating practices as a consequence of its fiduciary duties to an owner.
- An owner may be entitled to substantial damages as a result of violating its fiduciary duties under agency law.

In addition to all these points, we have already noted that the Restatement (Third) of the Law of Agency establishes a presumption that hotel management firms are obliged to refrain from practices that create or promote competition against a given property to which it is under agreement. It is on this basis that we now add *KMS v. Ritz-Carlton* to the list of precedent-setting cases, because Ritz-Carlton was unable to show in its defense that it had not violated a noncompete clause in its agreement with KMS (even though under agency law no such clause would have been required to protect KMS from competitive behavior on the part of Ritz-Carlton). We turn now to the particulars of the case itself.

KMS v. Ritz-Carlton: One Company, Two Luxury Brands in Partnership

When Marriott entered into its partnership with Bulgari S.p.A. in 2001, Ritz-Carlton was the natural choice to help develop, market, and manage the new properties. The Bulgari Bali differs from the Ritz-Carlton Bali insofar as it is smaller and consists entirely of fifty-nine luxury villas with no central hotel building. It features a restaurant, a bar, elaborate spa facilities, ocean views, and beachfront access. With Ritz-Carlton's exclusive brand image conveying the ultimate quality in hotel service and amenities and Bulgari's exclusive brand image conveying the ultimate style in jewelry and accessories, the new Bulgari Hotels and Resorts, a brand extension of Bulgari and a cobranded (Bulgari and Ritz-Carlton) division of Marriott, promised to set a new standard of luxury and haute couture in the hotel industry—hospitality in the grandest of styles. With both brands, Ritz-Carlton and Bulgari, the Marriott brand itself would remain in the background. We have already noted that such a strategy would prevent dilution of the Ritz-Carlton brand. The same should be true for the Bulgari brand.

Yet the Bulgari initiative would involve the Ritz-Carlton brand and the question became, Did Marriott, in arranging for Ritz-Carlton to help develop, market, and manage the Bulgari hotel properties, violate the brand rights that KMS had acquired through its management agreement with Ritz-Carlton? The answer, according to the jury, was an emphatic yes. The lawsuit that was filed on behalf of KMS alleged that it violated both territorial and other brand rights pertaining to its use of the Ritz-Carlton name, and we now consider the merits of that case in some detail. The jury, finding in favor of KMS, awarded $382,000 in compensatory damages and $10 million in punitive damages.[13] The jury also found that Ritz-Carlton had committed a material breach of the management agreement, which permitted KMS to immediately terminate its agreement with Ritz-Carlton. We discuss the final outcome of the case below. Here we attempt to explain why Ritz-Carlton was unsuccessful in its defense.

13. The parties subsequently settled the case for an undisclosed amount on confidential terms.

Ritz-Carlton argued that its role in the operation of the Bulgari hotels does not involve the use of Ritz-Carlton brand rights because the Bulgari brand name is strong enough to stand on its own, and neither of the existing Bulgari hotel properties bears the Ritz-Carlton name or logo on its premises. In whatever way the Ritz-Carlton name might have been used to promote these new hotels, there was nothing for the Ritz-Carlton name to add to the cachet of the Bulgari name, which, if anything, was positioned to provide an even more exclusive level of luxury and style than Ritz-Carlton. Moreover, according to the defense, Ritz-Carlton's agreement with KMS effectively made it an independent contractor, able to use its name freely for its own purposes.

To see why Ritz-Carlton lost its arguments, consider the following language from the management agreement between KMS and Ritz-Carlton. In particular, KMS argued, building the Bulgari Bali only about five kilometers from the Ritz-Carlton Bali violated clause 2.7 of the agreement, which provided the following protection against the potential competitive disadvantage of another Ritz-Carlton-operated hotel in the Bali market:

> 2.7 Territorial Restriction
>
> (a) From and after the . . . Commencement Date while this agreement shall be in effect, Operator [Ritz-Carlton] shall not, without prior approval of Owner [KMS] . . . open another hotel using the Ritz-Carlton rights within the Island of Bali, Indonesia. . . .

This clearly is the equivalent of a radius clause of this management agreement. In fact, the agreement prohibited Ritz-Carlton from managing a comparable hotel property on Bali for a ten-year period that would end in 2014, after which it provided for an approximately forty-five-kilometer radius within which Ritz-Carlton was not to operate such a hotel. The critical phrase in this clause is, however, "Ritz-Carlton rights." Yet Marriott's determination to jump on a worldwide marketing strategy bandwagon by using a successful brand from another industry to expand its luxury market offerings persuaded it to neglect the fact that by situating the new property on Bali it risked violating KMS's agreement with Ritz-Carlton.[14] Apparently no one considered the potential conflict with the Ritz-Carlton Bali to be serious enough to hold up the project because the new property would not be called a Ritz-Carlton. KMS was able to convince the jury, however, that the radius clause applied to this case because the manner in which the Bulgari was developed, managed, and marketed violated those brand rights acquired by KMS. To see this, consider the contractual language in which these rights were conveyed to KMS. The Ritz-Carlton brand rights include

> (i) the names and marks "Ritz-Carlton"; (ii) the Ritz-Carlton logo attached hereto as Exhibit B; and (iii) all other words, trademarks, indicia of origin, slogans and designs (including restaurant names, lounge names, or other outlet names) used or registered by Ritz-Carlton or any of its Affiliates and which are used to identify or are otherwise used in connection with Ritz-Carlton Chain hotels . . . all of the foregoing being indicative of the renowned Ritz-Carlton mystique, programs, processes, procedures, and systems (including the philosophy that drives customer satisfaction, the business management model, business strategies, the employee selection, training and career development approach, and the Ritz-Carlton Standards).

14. Similar partnerships have included Baccarat Hotels & Resorts, a partnership between Starwood Capital and Baccarat Crystal; and Armani Hotels & Resorts, a partnership between Emaar Hotels & Resorts LLC and Giorgio Armani SpA. Donatella Versace has a hotel property (but not yet a chain) in Australia, the Palazzo Versace, with another opening in Dubai.

In arguing that the relationship between Ritz-Carlton and Bulgari, in particular with respect to the Bulgari hotel in Bali, violated these rights, KMS focused its testimony on the intangible assets that Ritz-Carlton provided. In an exchange of testimony between expert witnesses for both sides, a witness for Ritz-Carlton argued that, because the Bulgari Bali did not publicly display the "Ritz-Carlton" name or logo on its physical, tangible assets—the facilities and grounds—Ritz-Carlton had not violated KMS's brand rights to the Ritz-Carlton name. In rebutting this testimony, an expert witness for KMS argued that the intangible attributes "are the very attributes underlying the Ritz-Carlton rights in this case."[15] Indeed, as we will make apparent here, KMS was able to show that the Bulgari Bali project publicly involved not only explicit references to Ritz-Carlton as a "partner" with Bulgari in various media but, more specifically, that it involved many elements of the list of intangibles in the above-quoted brand rights clause of the management agreement between KMS and Ritz-Carlton.

Not long after the Bulgari Bali's planned opening was announced, KMS saw that it would lose market share to the newcomer. KMS sent a letter to Simon Cooper, then the CEO of Ritz-Carlton, expressing the concern that Ritz-Carlton's activity with Bulgari on Bali was in violation of its contracted brand rights. The suit was brought after KMS found Cooper's response to be inadequate (the suit was first brought in California but moved to Maryland near Ritz-Carlton's corporate headquarters). Apparently the initial letter sparked some internal debate within Ritz-Carlton's and Marriott's management teams, but the potential upside of the initiative with Bulgari, for which the Bali market was already providing ample evidence, was too valuable to abandon. For its part, Ritz-Carlton argued that because it was an independent contractor with KMS it bore no responsibility for any fiduciary duties owed to KMS under agency law.

In the end, there was abundant evidence and testimony establishing that, in marketing terms, Marriott and Ritz-Carlton had arranged a cobranding partnership between Bulgari and Ritz-Carlton. In reference to the above-quoted brand rights clause of the management agreement, Ritz-Carlton was using the Ritz-Carlton name to market the new venture in the industry as well as Ritz-Carlton managerial expertise to manage the property.

As we have seen, cobranding occurs when two "parent" companies create a "child" by combining key aspects of their respective brands. KMS argued that this is precisely what Marriott did in bringing together the cachet of Bulgari style with that of Ritz-Carlton's hotel management reputation to create Bulgari Hotels and Resorts. Expert testimony from the case established this proposition to the satisfaction of the jury. In particular, it was shown that not only did the name "Ritz-Carlton" as well as references to it as Bulgari's "partner" appear on various web sites and other media available publicly (likely to be seen by industry insiders and customers alike), but Bulgari would be using Ritz-Carlton staff training and career development processes, the Ritz-Carlton central reservation system (reservations at Bulgari hotels can be made through either its own or Ritz-Carlton's reservation systems), a Ritz-Carlton booth at a trade fair, Ritz-Carlton's incentive system for travel agents and group travel brokers, and so on.

It was shown, for example, that Bulgari coveted Ritz-Carlton's hotel management

15. Dr. Chekitan S. Dev, Expert Report, "Rebuttals to the Critiques of My Opinions by: Dr. Jeffery Alan Durbin and Mr. Roger Cline," in Civil Action No 8:05-cv-00787-PJM, *P. T. Karang Mas Sejahtera*, Plaintiff, *v. Marriott International, Inc*., et al., Defendants, p. 6.

cachet to legitimize its hotel venture. Citing a quote from Bulgari CEO Francesco Trapani, an expert witness argued that cobranding was an explicit part of the strategy: "In lodging, the brand is becoming more important. You're happier if you're able to say, 'I went to a brand that's considered prestigious.'" Adding, "We could not afford to be unsuccessful," Trapani further indicated the brand value that Bulgari perceived in a partnership with Ritz-Carlton. After all, even though the Bulgari name is a worldwide symbol of luxury and haute couture, it had no prior association with the hotel business and might be perceived as inexperienced and potentially inept at hotel management. As the witness suggested, "Mr. Trapani feels that customers need to be convinced that they would not be disappointed at a Bulgari hotel because Bulgari hotels had the Ritz-Carlton hospitality engine under its hood."[16]

Testimony in the case established several other ways in which the Bulgari Bali violated KMS's contractual rights to the exclusive use of the Ritz-Carlton name and its obligation not to compete with KMS's property on the island of Bali. An official representing Marriott admitted in a deposition that the Bulgari Bali used Ritz-Carlton's recruiting and placement system (called Pearlnet) to staff the facility, its international sales organizations (ISOs) to market it, and its central reservation system to book customer stays. Moreover, the deposition shows that Bulgari had shared booths at trade shows with Ritz-Carlton (booths that would typically show the Ritz-Carlton logo and be appointed in Ritz-Carlton corporate colors) and that Ritz-Carlton rewarded travel agents for booking customers at Bulgari hotels. Moreover, the Marriott official also agreed with a statement that Bulgari relied on Ritz-Carlton for "operational and management activities unrelated to the physical appearance and construction of the hotel."[17]

On January 25, 2008, the jury handed down its decision to assess compensatory and punitive damages as noted above and to permit KMS to terminate its management agreement with Ritz-Carlton.[18] In the words of KMS's counsel, Bickel & Brewer, "Ritz-Carlton breached its fiduciary duty from a financial, operational, and competitive point of view," thereby committing "a material breach of loyalty" in using "the Ritz-Carlton name and brand to operate another hotel on the Indonesian island of Bali without our client's consent."[19] After the case was dismissed, KMS did terminate its management agreement with Ritz-Carlton. KMS has now contracted with another management company, the West Paces Hotel Group (which, not coincidentally, includes as its chairman and CEO Horst Schulze, who formerly worked for Ritz-Carlton), and rebranded its Bali property, officially becoming the Ayana Resort and Spa in 2009.

It is difficult to find much credibility in Ritz-Carlton's claims that the Bulgari brand name needed no help from Ritz-Carlton. KMS was, in the end, able to convince the jury that the cachet of the Ritz-Carlton brand was being exploited in a way that posed a competitive threat to KMS in violation of its fiduciary duties—and contractual arrangement—with Ritz-Carlton. In so doing, the jury also found the argument based on Ritz-Carlton's contractual status as an

16. Ibid., p. 10.
17. Dr. Chekitan S. Dev, "Supplemental Report," in Civil Action No 8:05-cv-00787-PJM, *P. T. Karang Mas Sejahtera*, Plaintiff, *v. Marriott International, Inc*., et al., Defendants, pp. 3–8.
18. The case was decided under the laws of the state of Georgia, United States, pursuant to a clause in the parties' Operating Agreement.
19. Bloomberg, "Bickel & Brewer: Ten Million Dollar Jury Verdict Announced," http://www.bloomberg.com/apps/news?pid=conewsstory&refer=conews&tkr=BUL%3AIM&sid=a04b13Zunp3k (accessed February 2, 2009).

independent contractor unconvincing, instead finding that Ritz-Carlton did, after all, owe to KMS a range of fiduciary duties that included not competing with another property it was operating.

Managerial Implications

KMS v. Ritz-Carlton was almost immediately hailed as an important case, confirming yet again the applicability of agency law to hotel management agreements, thereby providing legal recourse against perceived violations of fiduciary duties associated with agency law, even if a given agreement might seem not to impose such duties explicitly. In particular, it applied the noncompetition restriction that was included in the 2005 Restatement (Third) of the Law of Agency while shedding new light on the role of brand rights in hotel management agreements. No longer can a hotel management company, no matter the strength and scope of its corporate resources, successfully defend itself on the grounds that it acts as an independent contractor when arranging to manage hotel properties or that contractual clauses explicitly render its agency power revocable. Adding this case to the other four we have reviewed above, we argue that developers and property owners have achieved a much stronger position relative to that of the hotel management companies, a position that is now recognized by the courts—rather emphatically, considering the size of the judgment in this case.

In this era of profligate brand extension in industry after industry, these rulings should provide to prospective hotel property owners some measure of confidence that, when they enter busy hotel markets with multiple brand extensions and cobranded operations, they are protected against same-brand competition in their respective competitive sets and market segments. It should encourage them to challenge potential difficulties by reminding hotel managers that they owe to property owners a set of duties that may well supersede specific rights that are included in contractual language. The fiduciary responsibilities that include loyalty and not competing with existing properties apply regardless of specific contractual terms. Moreover, it should make it easier for property owners to include in management agreements explicit terms that reflect these duties, as managers can no longer assume that duties that are not explicit in agreements do not apply. As noted in an earlier commentary on the four 1990s cases we have reviewed here, these legal developments "have substantially shifted the balance of power between owners and managers, and have introduced an entirely new set of risks, liabilities, and uncertainties into the industry. . . . Management . . . companies have placed added emphasis on disclosing the details of their centralized services and corporate programs and the methods by which owners are charged for their services" (Renard and Motley 2003, 59). This should reduce the incidence of lawsuits against managers on the part of owners.

These rulings should also cause hotel management companies, especially the large ones with lengthy brand portfolios, to undertake expansion and enter new markets much more carefully than they may have in the past. The corporate meetings in which Marriott and Ritz-Carlton executives considered the letter from KMS initially protesting Ritz-Carlton's role in the Bulgari Bali would have to run a bit differently now. It can no longer be assumed that market expansion decisions involve only a simple calculation weighing minor settlement fees against prospective market gains. In the case discussed here, it is likely that, although they recognized that they might be on thin ice, the allure of a Bulgari–Ritz-Carlton partnership was too powerful to relinquish to avoid a lawsuit. The size of the awards (the court has not yet determined the legal fees, so the amounts remain tentative to that extent), which might well escalate in future cases should courts perceive that *KMS v. Ritz-Carlton* did not send a strong enough message to hotel companies, should be sobering. Perhaps the largest hotel management companies will continue to accept such legal actions as a cost of doing business, but it seems likely that they will from now on consider with much greater care the brand rights implications of expansion into hotel markets, avoiding such same-brand conflicts to a much greater extent than in the past, when they might have willingly undermined the market position of one managed property for the sake of a new one with greater market potential.

Alternatively, hotel firms might be more willing to assume the burdens of property ownership in some markets, since independent property owners seem now to have the upper hand. That will always depend in particular cases on detailed cost and profitability analyses, but these companies now realize that their efforts to build broad brand equity will be more difficult because they cannot do so without simultaneously promoting and preserving the rights of the owners of properties they manage. Indeed, Marriott assumes a 35 percent ownership stake in Bulgari Hotels and Resorts (Bulgari has the other 65 percent), a stake that would seem to provide a strong incentive to Marriott not to have Ritz-Carlton operate hotels with outside ownership in markets in which Bulgari operates (and ought to have made it sympathetic to the plight it created for the Ritz-Carlton Bali).[20] Such an ownership stake seemingly provides Ritz-Carlton with a stronger case that it has agency power with an interest in the Bulgari ventures, should a contractual dispute with Bulgari arise.

At this point, it remains to be seen what specific effect this lawsuit and KMS's termination of its agreement with Ritz-Carlton will have on large multibranded firms like Marriott, Starwood, InterContinental, Hilton, and Hyatt. After all, the Bulgari Bali remains in business, and Ritz-Carlton remains the engine under its hood. If the Bulgari Bali continues to grow its market share while the newly rebranded Ayana Hotel and Resort thrives under West Paces management, even such a large judgment might prove unpersuasive. On the other hand, that West Paces includes expertise from former Ritz-Carlton executives in its management structure may signal that Ritz-Carlton and Marriott will eventually face a formidable competitor in luxury markets, one that better understands the changing legal landscape in which market competition plays out. What we do know, based on our communication with the legal counsel of two large multibranded hotel companies, both of whom declined formal comment on this case, is this: hotel management firms are looking carefully at this case and thinking about its ramifications for negotiating their management agreements and developing brand strategy. Specifically, one change in business practice that can be attributed to the outcome of this case is that in management agreements, operating agreements are now being negotiated separately from brand rights in two separate documents, each with its own fee structure. We expect this will become a permanent change in modus operandi for the negotiation and administration of hotel management agreements by branded hotel management companies.

20. Tracie Rozhon, "For Bulgari, a New Look and New Ventures," *New York Times*, Business, April 6, 2007, http://www.nytimes.com/2007/04/06/business/07bulgari.web.html?_r=1&pagewanted=2 (accessed on February 2, 2009).

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