

## Do performance tests really work for management contracts?



**Many international operators now offer owners a performance test in their own template form of management agreement.**

However, invariably:

- the test does not apply for the first three or four operating years and the operator then has to fail the test for two consecutive years.
- this means that the earliest year that the owner could possibly terminate the management agreement because of the failed performance test would be the beginning of the sixth or seventh year;
- it is a two-tiered test. Frequently, one of the tests is based on failure to achieve a percentage of budgeted GOP or RevPar for two consecutive operating years; the other is based on failure to achieve a GOP/RevPar equivalent to a percentage of the average GOP/RevPar of several designated competitive hotels of similar size and quality as the owner's hotel in the neighbourhood;
- the GOP/RevPar of the competitive hotels is determined by an independent hotel expert (an additional cost to owner) but, if the expert is unable to certify the accuracy of the GOP/RevPar of the competitive hotels, the test will not apply for that year;
- if the hotels within the competitive set fall below a certain number, the test will not apply until the competitive set has again reached the required level;
- the test will not apply if the reason the operator failed the test was due to causes beyond its reasonable control, which frequently not only includes 'force majeure' but also other matters such as the carrying out alterations or renovation works to the hotel or to any of the competitive hotels;
- even if the operator fails the test, it can usually avoid termination by paying the difference between the figures it has actually achieved and the minimum figures it should have achieved in order to pass the test.

In summary, the chances of the operator failing such a test are remote.

### General provision

Usually, in hotel management agreements, there is a general provision on the part of the operator to the effect that it must professionally and competently fulfil its obligations regarding the management of the hotel or use the skill, care and expertise reasonably expected of an international operator of its standing.

There is, possibly, a danger that the performance test could be interpreted by a court of law as a yardstick for deciding whether the operator has managed the operation of the hotel in accordance with such a provision.

If, for example, the performance test required the operator to achieve at least 80% of the average RevPar of selected competitive hotels for two consecutive years and, for five consecutive years, the RevPar was consistently well below the average RevPar of the

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competitive hotels but above the 80% threshold, the operator has not failed the performance test.

In these circumstances, could the owner claim that the operator had failed to manage the hotel competently and professionally or had failed to use the skill, care and expertise reasonably expected of an international operator of its standing?

The owner's claim under the general provision may well have a greater chance of success if there was no performance test in the management agreement.

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