Defensive Contract Negotiation

Risk management tips and strategies help your organization avoid disputes and losses

BY JOHN FOSTER, ESQ., CHME

To be successful in today's convention and meeting industry, both planners and hoteliers must negotiate defensively. To ignore or misunderstand this reality can potentially expose your organization or company to future disputes and expensive losses.

Every hotel contract involves the risk of underperformance or nonperformance on both sides. If you are questioning whether it's worth the extra time to negotiate the fine print, remember: If you ask the other side for something before the contract is signed, it's called "negotiating." If you ask for something after the contract is signed, it's called "begging." Obviously it's much better to ask for favorable details while you are on the negotiating side.

Here are some risk management tips and strategies to consider when negotiating your future meeting contracts.

➤ **Use a request for proposal (RFP) to choose sites and hotels.** The RFP process is the best way for planners to separate the bona fide prospects from the suspects. The RFP can be used to determine which hotels are agreeable to the terms that are important to the meeting sponsor and which ones aren't. Negotiate with the agreeable hotels first.

➤ **Don't agree to any attrition or performance clause unless circumstances justify it.** Hoteliers created attrition clauses and minimum guarantees in the late 1980s and early '90s, with the economy on the upswing, to transfer the risk of low pickup from the hotel to the meeting sponsor. If a hotel holds your group rooms out of inventory and turns away other legitimate business, it is reasonable to require your group to pay for rooms your group didn't use and the hotel couldn't sell to anyone else. The legal term for this is "detrimental reliance."

Suppose an organization is considering, for its next mid-size meeting, a city and hotel whose average occupancy percentage is in the 60s. Assume that the hotel will confirm a very low group rate if the organization signs now, because the organization's preferred dates are during a historically low season for the hotel and city. The hotel gives its assurances that the organization and its attendees will probably have the entire hotel to themselves. The organization decides to take this fabulous offer and starts contract negotiation.

Does it make sense for the organization to put itself at risk by agreeing to minimum performance guarantees? Based on historical records for this city, it is unlikely that the hotel will be in a position to detrimentally rely on the group contract by turning other groups away over the same dates. (This assumes that the World Series, the Super Bowl, or the Pope does not decide to come to this city after the contract is signed.) If this hotel has 1,000 rooms, and the group books 500 of them but only uses 300, the hotel hasn't really suffered reliance damages; it just didn't make the revenue it had projected.

During contract negotiations, it might be prudent for this group's planner to negotiate a "best efforts" provision. The meeting sponsor gets a special group rate in return for using its best efforts to promote the hotel to its attendees for housing. The hotel receives the group's business, but no minimum guarantees. The contract should also state that if the hotel gets a verifiable offer for a definite piece of business over the same dates, the group gets a first right of refusal to guarantee some or all of its future block. Although the meeting sponsor will not have the assurance of certain perquisites in this type of arrangement, the contract can state that comps, upgrades, staff discounts, etc., will still be applicable if the group picks up a certain amount of rooms. Also use a "best efforts" clause in overflow hotel contracts.

➤**Under-forecast your room block.** The best room block forecasting strategy is to hope for the best, but plan for the worst. If your group used 1,000 rooms at your last annual meeting, a 700-room block would be a good place to start for your next one. You can book more rooms later if you need them. Groups that use more rooms than originally contracted are always held in higher regard by hotels than groups that over-book and want to unload unused rooms on the hotel.

However, many planners are perpetually concerned that they won't have enough rooms to accommodate all of their attendees and that rooms won't be available when they ask for more. If that description fits you, do a risk-benefit analysis. Compare the risk of not having enough rooms in the headquarters hotel and requiring that late-booking attendees stay elsewhere versus the risk of booking too many rooms in the hotel and having to pay thousands of dollars in attrition damages. Pick one option and prepare your contract accordingly.

➤**Be strategic in how the attrition (performance) clause is worded.** If circumstances justify that the meeting sponsor gives minimum guarantees to the hotel, consider including nine strategic points — from damage computation to audit provisions — in a well-written attrition clause (see page 38).

➤**Include contract terms that allow the meeting sponsor (or attendees) to replace canceled rooms with substitute names both before and after the cut-off date.** Most hotels will agree to these terms, but you usually have to ask for them.

➤**Include a term in the contract that late reservations will be accepted at the group rate up to the last room available in the hotel.** Hotels use yield management policies to justify accepting reservations from a group after the cut-off date on "space and rate availability." This policy is contradictory to the principle in contract law that says one party cannot interfere with or make more difficult the other side's performance of the contract. By raising the group's rates after the cut-off date, the hotel is discouraging attendees from making a reservation at that hotel. It's fine if a hotel wants to use yield management to raise rates, but attrition damages should not apply.

➤**Include a formula for how future rates will be set.** Hotels and meeting sponsors negotiate rates for long-term future bookings by referencing current group rates plus a maximum percentage increase. To be reasonable, future rate increases should allow the hotel to adjust rates according to inflation, yet be competitive with comparable hotels nearby. Rates should be adjusted by the lesser of the change in the Consumer Price Index-Urban (CPI-U) or a certain percentage off the hotel's published rates. The percentage off future published rates should equal the percentage that the current group rates are below published rates.

➤ **Shift the risk of attrition in sub-blocks to the organizations booking rooms in those blocks.** State in the contract that the hotel will require credit card information from companies blocking 10 or more rooms within the overall block. The contract should

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specify that the hotel will look to these companies for payment if their block isn't fully used.

➤**Don't agree to pay both attrition and meeting room rental unless your rooms-to-space ratio is out of balance.** The general rule of thumb is that an in-house group is entitled to complimentary meeting space in the same percentage as the number of group rooms used in the hotel. If your group uses 30 percent of the rooms allocated for group business in the hotel, it is entitled to 30 percent of the meeting space on a complimentary basis; if your group needs 50 percent of the meeting space, you should pay for the extra 20 percent. On the other hand, if your rooms-to-space ratio is balanced, and you are required to pay for attrition and meeting room rental, you are agreeing to pay twice to cure the same deficiency.

9 Strategic Points in a Well-Written Attrition Clause

1 Base damages on lost profit, not 100 percent of the lost revenue. Lost profit is defined as gross revenue minus variable expenses, not 100 percent of lost revenue. Hotels track profit and loss separately in each revenue-producing department. In order to know whether a damage clause is asking for "too much" or "too little," you have to know what percentage of revenue represents lost profit to a hotel. The industry average profit margin in guest rooms is 70 percent to 80 percent; in catered food, 30 percent to 40 percent; and in alcohol, 80 percent to 85 percent. Formulas for attrition damages should be based on these percentages.

2 Guest room attrition should be based on a combination "per night" and "cumulative" basis. Analyze each night of the group's stay to see if the room usage meets the minimum required based on allowable attrition. On nights guest room usage exceeds the minimum, the overage should carry over cumulatively to subsequent nights so that it offsets any nights the group is under the minimum.

3 Define "sold" and "sold out." A "sold" room should be defined as all of the following: rooms occupied by a paying guest, rooms comped to a group or individual, and rooms billed to other groups or individuals for attrition, cancellation, no-show, and/or early departure. "Sold out" should be defined as the hotel's total inventory minus off-market and sell-last rooms. Off-market rooms include those being repaired, renovated, and/or comped. Sell-last rooms include rooms held for last sale to members of hotel's preferred guest program. Also, consider stipulating that suite parlors will not count in the inventory.

4 Account for "sold out in advance" situations. Meeting sponsors should not be responsible for any attrition damages if the hotel represents itself as being sold out to anyone attempting to make a reservation prior to arrival or check-in, and that no additional reservations will be accepted on one or more nights of the group's in-house dates. The fact that the hotel may open up and have rooms to sell later over the group's in-house dates is not something the meeting sponsor can control and should therefore not be held responsible.

5 Anticipate changes in the economy and provide for revisions in the contract. If the economy declines substantially after the contract is signed, the contract should allow the meeting sponsor to revise attendance and room block projections without limits or liability. Planners and hoteliers can use terms in the contract that allow future room blocks and attendance forecasts to be revised based on the economic indicators published by experts. The recognized leading source for economic statistics is the Conference Board, a nonprofit organization that tracks 10 leading economic indicators. Its data with analysis can be located at www.conference-board.org.

6 Base attrition damages on the hotel's average occupancy for the past three years during the same period. Suppose you are negotiating with a resort in Scottsdale, Ariz., for a meeting in July, and the property's occupancy in that month historically runs between 50 percent and 60 percent. It's valid to use the high-end figure of 60 percent in attrition calculations: A 500-room hotel becomes a 300-room hotel for attrition purposes (500 minus 40 percent equals 300). The property does not have a realistic expectation of running a higher occupancy than that, so when that level of expectation is reached, the hotel should be satisfied (not wildly ecstatic, just satisfied).

7 State that all rooms occupied in the hotel by your group's attendees will count toward your group's pickup to reduce attrition damages, regardless of rate paid. Hotels, not meeting sponsors, ultimately make the final determination as to what rate an individual pays. If the hotel wants to offer discounted rates on its Web site or on Internet sites, that's fine, as long as attendees who obtained a discount rate are still counted in the group's pickup.

8 Insist on an audit provision. This idea, which I first introduced in a *Convene* article in 1996, is finally catching on. A hotel asserting a claim for attrition damages has the burden of proving that those damages are legitimately owed. A meeting sponsor should always have the right to look at the hotel's in-house records to independently ascertain the accuracy of the hotel's claim. (This right exists without an audit provision as well.) Those individuals looking at the records should agree in advance to sign a confidentiality agreement in order to meet privacy requirements.

9 Insist on credit for unused comps. A term frequently seen in hotel contracts is: "Comp rooms must be used during the meeting dates. Comps have no value and cannot be applied as a credit to the master account." Why not? In legal terms, meeting sponsors give "consideration" in order to receive the comps. Since comps are earned, they have value. If your group doesn't use all its comps, then it should receive a credit for the unused comps at the group rate on the master account. ■

➤ **To avoid unreasonable risks, insist on a comprehensive "termination and excuse of performance" clause.** A comprehensive clause will provide for both partial and total nonperformance. It will also reference any event or occurrence outside either party's control that prevents one or both of the parties from performing in part or in whole. Insist on including references to terrorism, threat of terrorism, or the reasonable personal safety fears of potential attendees.

This clause in the agreement is not intended to be a free pass for either side to walk away from the contract, unless the reason is valid. However, it is intended to prevent injustice by requiring one side or the other to pay nonperformance damages when the cause was outside its reasonable control. This concept is supported in both contract statutes and case law.

➤ **Provide for the possibility of a new hotel being built.** Every planner (and hotelier) cringes when news comes out that a new hotel will be built in close proximity to the headquarters hotel already under contract. The new hotel will invariably undercut the rate at nearby existing hotels to attract business. This practice will motivate your attendees to stay at the new hotel, resulting in attrition at the current headquarters hotel.

Under these circumstances, it is unconscionable for the first hotel to hold the group responsible for attrition. The hotel contract should address this possibility by allowing the group to reduce its block in advance without liability.

➤ **Provide incentives for exhibitors to make reservations in the official room block.** Convention and trade show planners have to decide if they want to require exhibitors to stay in the headquarters hotel, guaranteeing that rooms will be picked up. Alternatively, some show sponsors require that exhibitors not stay in the headquarters hotel in order to allow regular attendees to stay there. Once this decision is made, incentives can be offered, including discounts on booth fees and priority points for booth placement at future shows.

➤ **Have attendees prepay a nonrefundable package rate for the convention that includes attendance at the event and a hotel room.** This strategy will make it mandatory for attendees to stay within the official block at contracted hotels, thus reducing attrition. However, some attendees will resent being told where they can stay and will be motivated to make reservations at the last minute when their plans are firm.

An Option to a Minimum Guarantee

The following clause can be used when the meeting sponsor wants to give the hotel the opportunity to receive attendee reservations but not a minimum guarantee.

GUEST ROOM BLOCK

1. In consideration of the ABC Organization selecting the Hotel to host ABC's meeting, Hotel agrees to hold the room block specified in this agreement for use by ABC's attendees until the Cut-Off Date. In return, ABC will list the Hotel on its Official Housing Form and will use its best efforts to offer and promote the use of the Hotel to its attendees. ABC will also use its best efforts to completely fill the allocated number of rooms, but reserves the right to revise this block at any time without liability should attendance not materialize. The arrival and departure patterns and the number of rooms outlined in this agreement are an estimate only based on the history of previous meetings held. The actual pattern and number of guest rooms used may vary from what is currently listed in the contract. ABC will not be responsible for rooms not used by its attendees unless ABC later guarantees the rooms.

2. Hotel will notify ABC in writing if another verifiable group makes a bona fide request for rooms at the Hotel that are being held for ABC. ABC will have the right of first refusal to guarantee payment for some or all of the unreserved rooms being held by Hotel in ABC's room block. ABC will be responsible for the use or payment of all room nights it has guaranteed. ABC will not be responsible for rooms once they are reserved by its attendees nor for rooms later released to the Hotel that Hotel sells to other guests. ABC will pay for guaranteed rooms that go unsold at 75 percent of the group rate to compensate Hotel for its lost profit. ■

➤ **Include a provision that gives the meeting sponsor the right to assign some or all of its unused room block and meeting space to another group.** Most hotel contracts have a boilerplate provision, which generally says that neither party will assign any of its rights or obligations in the agreement, in whole or in part, without the written consent of the other party. This is reasonable, since both sides have a right to approve with whom they do business. With an uncertain economy, however, it may be time for meeting sponsors to negotiate the right to assign the use of some or all of their unneeded guest rooms and meeting space to another group.

Building your own model contract template can provide your association with alternative clauses to what the other side proposes.

Some hotels will object because they prefer to require attrition damages from the first group and book the second group as new business. These terms can be negotiated upfront by requiring the replacement group to meet certain criteria before the first group is off the hook. In the alternative, assignment could still take place, but with the first group guaranteeing the performance of the replacement group. There are many creative ways to look at this arrangement to make it workable for all sides.

➤ **Provide for a date change versus a cancellation.** If the meeting sponsor wants to move the meeting to alternate dates, most hotels would consider this a cancellation and rebooking. Most meeting sponsors would call it a date change that shouldn't require damages to be paid. As a compromise, the contract can state that if the date of the meeting is changed and certain criteria are met, it will not be considered a cancellation and rebooking.

➤ **Create your own standard contract template.** Many associations have already sought legal assistance in preparing a model contract template to send to hotels. Although the side that puts its terms on the table first has an initial advantage, the reality is that the final contract will be a compromise between what both sides want. Having your own contract template is still a good idea because it gives you clauses to suggest as alternatives to what the other side proposes.

Legal concepts and strategies in the meetings industry have gotten too complex for most planners and hoteliers to act as their own counsel. Seek the assistance of an attorney familiar with the industry to advise you. The money you spend in the short run will potentially save you a lot more money in the future. ■

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