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"Mutual" Cancellation Clauses; Desirable or Dangerous?

Many meeting planners fall victim to the assumption that the best way to make a contract fair is to make as many clauses as possible "mutual." As a result, a growing trend is for planners to ask hotels to make their cancellation clause "mutual," so that if the hotel cancels the group it would be required to pay the group the same amount of damages that the group would have to pay if the group cancelled the hotel. While on the surface it sounds like a good idea, it actually poses far more risks than benefits.

Basics of Liquidated Damage Clauses

To understand why mutual cancellation clauses are a not a good idea, you have to first understand a little about liquidated damages. Generally, whenever a contract is breached the other party is legally entitled to collect monetary damages suffered as a result. No clause is needed; the law automatically will award damages. However, sometimes the parties agree in their contract on the amount that will be paid in the event of a breach. The law allows contracting parties to do that when it is clear that an injury will occur in the event of a breach, but it is difficult to determine the amount. Instead of requiring the injured party to prove how much it lost, the parties simply agree in their contract on the amount that will be paid, which is known as "liquidated damages."

In hotel contracts the parties typically agree on liquidated damages that will be paid for the group's cancellation or lack of full performance of the contract (referred to in the industry as "attrition"). The key to the legal enforceability of a liquidated damage clause is that it must be **a reasonable estimate of the loss that the injured party would suffer** as a result of the breach. That is why cancellation clauses usually have a sliding scale of damages that increase as the date of cancellation gets closer to the date of the scheduled event, on the assumption is that the closer in time the cancellation occurs, the less likely it will be that the hotel can resell the cancelled accommodations, thus the hotel will suffer a greater loss.

The cancellation damages are intended to reflect an estimate of all the losses that a hotel suffers when an event is cancelled, including lost revenue from: guest rooms; food and beverage; audio visual services; ancillary services that the individual guests would use like room service or the bar; and the time and effort that the hotel invests in selling the event and in attempting to resell. The hotel cannot determine the profit it makes on an individual room or group of rooms, which is it why it is so difficult to

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prove its actual loss, but it does know its overall average profits and considers the overall profit potential of an event when setting the amount of damages. The damages agreed upon do not have to be a perfect estimate. If it turns out that the actual loss is higher or lower the injured party is still entitled to the amount agreed upon so long as the amount was reasonable at the time the contract was signed. On the other hand, if the amount of damages agreed upon was unreasonably high at the time the contract was signed, a court can refuse to enforce the clause and instead will require the hotel to prove its actual losses.

- Cancellation of a Group by a Hotel Does Not Cause the Same Loss

There are times when a hotel finds that it must cancel a group contract, such as when a previously unplanned renovation project is scheduled, and hotels are well aware that the law requires them to pay damages that the group suffers as a result. The problem with a "mutual" clause is that while there is a basis for estimating the losses a hotel may suffer due to a cancellation, the damages that a group may suffer when a hotel cancels it are not as easy to reasonably estimate at the time the contract is signed.

The contract sets forth the number of room nights reserved, the food and beverage events that will be held and the other commitments made by the group so it is not difficult to determine the minimum revenues that the hotel would lose due to a cancellation. On the other hand, if the hotel cancelled the group, what would the group's losses be? The amount could vary widely. If the cancellation occurred well in advance, the group might be able to find another hotel in the same city that could accommodate all of its needs at the same or better rates. If the group had not spent money to advertise the original hotel, the group might not incur any expenses that it would not have paid otherwise. When the cancellation occurs at the last minute, the group might have to scramble to do a site visit to find a new location, might incur some higher pricing at the new location and might have to reprint materials or incur the costs of notifying attendees of the change. Despite those expenses, it is very unlikely that the group's damages would add up to the large loss that the hotel would suffer due to a cancellation. On the other hand, in some rare instances the group might not be able to find a new location in time to hold the event, requiring it to cancel entirely which could lead to the loss of the group's primary revenue source for the year. At either end of the spectrum, the amount that the hotel would lose has nothing to do with losses the group might suffer.

- How Would a Mutual Cancellation Clause Be Viewed Under the Law?

A judge or arbitrator looking at a mutual cancellation clause would first notice that the parties agreed at the time that the contract was signed that each side would suffer **exactly** the same loss in the event of a cancellation. It would be extremely unlikely in almost any contract situation that each side would suffer the same loss if the contract

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were cancelled, calling into question the reasonableness and enforceability of the clause.

As a result, the judge would likely ask the group to provide evidence of the expenses that it anticipated that it would incur as a result of a cancellation at the time the contract was signed. It is important to remember that the actual losses are irrelevant: the court looks at what the parties estimated their loss would be at the time they were negotiating the contract. The legal question is whether the clause was fair at the time the parties agreed to it. If the judge determined that the cancellation amounts were not based on any reasonable estimate of the group's potential losses, the judge could rule that the cancellation clause was an unreasonable penalty being imposed on the hotel and would not enforce it. The group would then have to prove its actual loss in order to recover.

- Why Do Hotels Resist Mutual Cancellation Clauses?

Hotels do not like mutual cancellation clauses because they understand that the damages a group will suffer due to a cancellation are not exactly the same as the amount the hotel suffers, so they recognize that a mutual clause is legally inappropriate. Further, since most of the time the losses that a group suffers are less that those suffered by a hotel in a cancellation, a mutual clause is simply not fair to a hotel.

If there is no clause in the contract relating to what the group will be owed then the group will be legally entitled to its "actual damages," the reasonable expenses it incurs or losses it suffers as a result of the cancellation. Some times that many be a small amount, while in rare cases it could be a large amount, but either way the hotel will pay what is fair compensation to the group. Alternatively, if the group wants a liquidated damage provision, the amount agreed upon should not be the same as those that would be paid to the hotel; it should be a separate clause that reasonably estimates the losses that the group would suffer.

The best way to evaluate whether a mutual clause is truly fair is to consider a hypothetical application of the clause for both parties. While in some instances mutual obligations may be appropriate, in cancellation clauses "mutual" does not equate to "fair" and more importantly it could lead to legal issues that are not beneficial to either side.

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