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✚ Resale Clauses in Liquidated Damages—Crafting the Best Clause Possible

When hotel customers are negotiating event contracts, they often insist upon a “resale” clause, when in fact adding resale credit to a liquidated damage clause is not just contrary to the law of liquidated damages¹, it usually isn’t really fair to the hotel. There are as many different resale calculation methods in the event industry as there are customers. But if a hotel is going to add a “resold guest room credit” to a liquidated damage provision as a concession to a customer (*since it is not legally required*), the most reasonable method for calculating resale is based on revenue instead of guest room count and matching the credit to the percentage of damages owed.

For purposes of discussion, assume a hotel contract with the following key terms:

Guest Room Block		Rate		Revenue
	200		\$125	
				\$25,000
Cancellation 6 mo. before event:				
Damages = 50% of room revenue				\$12,500

The 50% is used because the hotel is estimating that if the event cancels six months in advance, it will be able to resell about half the rooms, so the customer is only obligated to pay half of the lost revenue. If the customer cancels at a time closer to the event date, the hotel assumes that it will have less chance to resell the rooms, which is why the damages are typically higher as the cancellation date gets closer to the event. The whole point of liquidated damage clauses in hotel contracts is that the tiers of damages included are used to estimate both the loss AND resale. Because of that, under the law of liquidated damages, the injured party (the hotel) has no obligation to give resale credit or prove actual loss!

Some customers nevertheless request resale credit. If the customer is concerned that the hotel’s estimated loss is too high and that the hotel will resell the cancelled inventory, the preferred way to address it is to change the damage percentage, say from 50% to 40%, rather than adding resale.

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A Clause That Says Only “Less Rooms Resold” is Not Enough.

If a hotel does agree to a resale clause, the contract must include a formula for how resale will be calculated. If the clause just says something about “less rooms resold” it will create a legal dispute, as there are many ways resale could be calculated. Court cases and arbitrations in the meeting industry involving disputes over how “resale” is to be determined when it was not defined in the contract have cost groups and hotels lots of time and money. That is not good for either party.

Why is a formula necessary? Hotels do not hold guest room blocks by room number, so there is no way to know which rooms sold in the hotel would be the group’s cancelled rooms or not the group’s. It’s not possible to say that room 1535 was the group’s room that got cancelled and was either resold at a rate of \$100 or that it sat empty. Under the law, the hotel gets to sell all of its other inventory once before “reselling” inventory cancelled by this customerⁱⁱ. That is why well drafted resale clauses make clear that the customer’s cancelled rooms will be the last rooms sold. In the above example, if the hotel had a total of 500 rooms and the cancelling customer reserved 200, the hotel would get to sell 300 rooms before “reselling” the customer’s rooms. If the hotel sold 310 total rooms on the night the customer cancelled, the customer would get credit for 10 “resold” rooms. This is how the resale calculation would look:

Total rooms in Hotel	500
Rooms out of order or off market	0
Net total rooms available in hotel	500
Rooms blocked by group	200
Rooms available in excess of group rooms blocked	300
Total Rooms occupied in hotel	310
Room pick up by group (0 due to cancellation)	0
Total rooms sold by hotel in addition to group pick up	310
Group Rooms Resold, if any	10

The credit is only 10 rooms because the hotel could have sold the other 300 rooms even if the group had not cancelled, so those 300 rooms are not part of the cancelled block.

Crediting Revenue Instead of Numbers of Rooms Resold.

Once the number of rooms resold is calculated, there is still the question of what credit the group should receive. The fairest method for both parties is to use revenue rather than numbers of rooms. That is because it is possible that the hotel resells all of the group's cancelled rooms, but at rates much lower than the \$125 that customer was contracted to provide. So even though rooms were resold, the hotel did not fully make up for its loss. If in this case the rooms were all resold at \$100, the hotel would make only \$20,000 instead of the \$25,000 it would have made from the cancelled contract. So, the fact that the hotel resold the number of rooms cancelled by the group does not necessarily mean that the hotel fully made up its loss. On the other hand, it is also possible that the hotel could resell the rooms at higher rates, and if it does, by giving revenue credit, the customer gets the benefit of that higher rate. If for example the hotel resells the rooms at \$200 instead of the customer's contracted \$125, the hotel would only have to resell 125 rooms out of the 200 to fully make up the loss, a benefit to the customer! So that is why it is more reasonable to credit resold room revenue rather than just numbers of rooms resold.

Contracted Revenue= 200 @ \$125	\$25,000
200 resold @ \$100	\$20,000
Loss to hotel	\$5,000
125 resold @ \$200	\$25,000
Loss to hotel	\$0

As stated, hotels don't hold room blocks by room number, so how does the hotel know whether the group's rooms were resold at \$100 or \$200? The truth is, it doesn't. Hotels sell rooms at a wide variety of rates every night. That is why it is typical for resale clauses to give revenue credit at the hotel's Average Daily Rate for the day. Each side shares equally in the rooms sold at the highest and lowest rates. Is this method perfect? No, as it can't account for the many other factors that impact whether or not the hotel has made up its loss, including whether the resold rooms were commissionable; whether they had other terms included, like a free breakfast; or what it cost the hotel in time, effort and money to go back and resell rooms that had already been sold once to the cancelling customer. The whole reason liquidated damages are used in the first place is that it is extremely difficult to determine a hotel's actual loss, and these are many of the reasons why. However, using the Average Daily Rate is generally accepted as the most reasonable way to calculate a fair resale rate.

The Resale Credit Should Match the Percentage of Damages Paid.

Determining the number of rooms resold and the average rate should not be the end of the calculation. It is also important to match the resale credit to the damages percentage paid by the cancelling customer. In the example, the cancellation damages owed are 50% of revenue, so the customer should get credit for 50% of the revenue from rooms resold. This makes sense. The hotel has lost \$25,000 but is only being paid \$12,500 in damages. If the hotel resells half the rooms at \$100 and gives customer credit for the full value, the hotel would have to give \$10,000 credit and customer would owe only \$2,500, even though the hotel only resold half of the rooms. If the hotel gives credit at the same 50% that the customer owes, the credit is only \$5,000 and customer owes \$7,500. The hotel was expecting \$25,000 in revenue. It gets \$7,500 from customer, and keeps \$5,000 of the resale revenue, for a total of \$12,500. The hotel is still out \$12,500 of the original \$25,000 that it expected. So even when giving resale credit at the same percentage as damages paid, the hotel does not always fully make up for its loss. It's easier to see it in the table below. The column marked "Example 1" shows how resale credit would be calculated if the hotel gave credit for 100% of the resold room revenue. Example 2 limits the credit to 50% of the resold revenue (the same percentage as the damages owed), and Example 3 has no resale credit.

	Ex. 1	Ex. 2	Ex. 3
CONTRACTED REVENUE	\$25,000	\$25,000	\$25,000
50 % Damages Owed Per Contract	\$12,500	\$12,500	\$12,500
100 % Resale Revenue Credit (100 rooms at \$100)	\$10,000		
50% Resale Revenue Credit (same % as damages owed)		\$5,000	
No Resale Credit (Regular Liquidated Damage Clause)			\$0
Damages owed by Group after resale credit	\$2,500	\$7,500	\$12,500
Total received by hotel from group & resale	\$2,500	\$12,500	\$22,500
Loss of revenue to hotel	\$22,500	\$12,500	\$2,500

It's clear from Example 2 that even if you limit resale credit to the same percentage of damages as the group paid, the hotel still may not make up its loss. That is why if the customer thinks that the hotel will end up selling more than the liquidated damage clause estimates, it is better to adjust the damage percentage than to try to add resale.

Contrary to the common claim by customers that the hotel is "double dipping" by getting liquidated damages if there is no resale, the reality is that more often it is the customer "double dipping," as the group is already paying only a portion of the hotel's loss, and then gets that compromised amount due is further reduced by resale even though the hotel has not fully made up its loss. Are there times that the hotel resells more than it estimated when setting the percentages in the damage clause? Of course, but it is less common than customers seem to think. Also, when a customer cancels a contract, the hotel suffers other losses that are not recouped when counting rooms resold.

Liquidated damages are not a perfect calculation. Sometimes the damages are more beneficial to one side or the other, and both sides assume the risk of that possibility when negotiating the damage clause. Remember that the damages are not required to be perfect, they are only required to be a "reasonable estimate" of a loss that the parties agree is difficult to determine with certainty. Agreeing to liquidated damages creates certainty and avoids the need to prove actual loss, which is very time consuming and expensive for both parties. Negotiating a lower damage percentage rather than adding resale allows the parties to resolve a cancellation immediately, rather than having to wait for the event dates to pass to determine resale.

A resale credit is not required under the law when the parties make a reasonable estimate of the potential for resale in their damage clause via the sliding scale of percentages. However, if a customer insists on resale credit, the best and most fair way to address the issue for both parties is to make clear that the credit will be based on "last rooms sold" and that the credit will equal the revenue from rooms resold times the percentage of damages due under the cancellation clause.

ⁱ For a complete explanation of why resale is not required in liquidated damages, see my separate article, "Profit and Resale in Liquidated Damages Clauses."

ⁱⁱ Restatement (Second) of Contracts §347, "Measure of Damages in General" comment f.