

BY DAVID K. BOWSHER AND ANDREW B. FREEMAN<sup>1</sup>

## Liquidated Damages Clauses in a Bidding Procedures Order

In *The Brown Publishing Company Liquidating Trust v. Brown Media Corp. (In re Brown Pub. Co.)* (*Brown v. BMC*),<sup>2</sup> the bankruptcy court interpreted a provision in the sale procedures order entered in connection with a § 363 sale to be an improper liquidated damages provision, and as such, the good-faith deposit was required to be returned to the successful bidder, who ultimately failed to close.

### *Brown v. BMC*

The assets of The Brown Publishing Company Liquidating Trust were being sold through an asset sale conducted pursuant to § 363 of the Bankruptcy Code. In the § 363 sale, the highest bidder for substantially all of Brown's assets was the stalking-horse bidder, Brown Media Corp. (BMC). According to the bidding procedures, all potential bidders were required to put down a 5 percent good-faith deposit in order to be qualified to bid. Even though BMC, as the stalking horse, was not required by the bidding procedures to make the deposit, as a matter of fairness the bankruptcy court nevertheless required BMC to make a good-faith deposit totaling \$765,000. BMC failed to complete the purchase of Brown's assets.

Upon BMC's failure to close, Brown sold its assets to the second-highest bidder, PNC Bank NA. Strangely, upon further negotiations, the final price paid by PNC (and a co-bidder) ended up being higher than BMC's highest bid in the § 363 sale. On the claims bar date for administrative expense claims, BMC filed a claim requesting that Brown return its good-faith deposit. Brown refused to return the deposit and filed an action for a declaratory judgment that Brown was entitled to keep the good-faith deposit. Brown's argument was based on a provision within the bidding procedures that read:

[I]f the Successful Purchaser fails to close the Sale, the Successful Purchaser's Good Faith Deposit shall be retained by the Debtors on accounts (sic) of damages suffered by it as a result of such failure to close, without prejudice to the Debtors' ability to seek to recover additional damages from the Successful Purchaser.

Brown contended that the above provision was a liquidated damages clause, which would entitle Brown to retain the good-faith deposit in its entirety. The bankruptcy court, however, applying New York

law, held that the provision was not an effective liquidated damages provision. The court explained that under New York law, if a liquidated damages provision provided for additional recourse, then the liquidated damages portion of that provision was to be read out of the contract. Applied to this case, the court held that since the relevant clause provided for additional remedies on top of the retention of the good-faith deposit, the clause was not an effective liquidated damages provision. The court went on to hold that Brown would have to prove its damages.

Generally speaking, upon a breach of contract, the nonbreaching party is entitled to actual damages.<sup>3</sup> The amount of actual damages is determined by actual loss suffered by the nonbreaching party.<sup>4</sup> A liquidated damages provision is an attempt by the parties to fix the damages for breach of a contract prior to a breach occurring. Liquidated damages provisions are beneficial in that they save both time and money by avoiding a trial to determine the monetary value of the actual damages.<sup>5</sup> Generally, a liquidated damages provision fixing the damages payable upon a breach is permissible if (1) the amount is a reasonable forecast of the harm caused by the breach and (2) the actual damages are difficult to predict.<sup>6</sup> A court will not, however, enforce penalty provisions, as they are deemed to be against public policy.<sup>7</sup> Thus, a liquidated damages provision must be a reasonable estimation of the damages, rather than a penalty.<sup>8</sup>

In *Brown v. BMC*, the damages provision of the bidding procedures provided that Brown was entitled to keep the good-faith deposit and seek additional damages. However, the bankruptcy court refused to recognize such language as an effective liquidated damages provision because it did not fix damages. Perhaps the most striking aspect of the court's ruling is the treatment of the bidding procedures like a contract. Effectively, the court decided that when bidders submit bids agreeing to be bound by the terms of the bidding procedures, said procedures become contractual terms subject to state law interpretation. As the court noted, an actual-damages provision and a liquidated damages provision are "incompatible," because liquidated damages provisions are intended to prevent having to determine the actual damages.<sup>9</sup>



**David K. Bowsher**  
Adams and Reese LLP  
Birmingham, Ala.



**Andrew B. Freeman**  
Adams and Reese LLP  
Mobile, Ala.

David Bowsher is the partner in charge of Adams and Reese LLP in Birmingham, Ala., and Andy Freeman is a partner in the firm's Mobile, Ala., office.

1 The authors thank Kyle S. Navarro for his assistance in helping prepare this article.  
2 486 B.R. 46 (Bankr. E.D.N.Y. 2013).

3 Restatement (Second) of Contracts § 347 (1981).

4 *Id.*

5 *Id.* at § 356.

6 Restatement (First) of Contracts § 339 (1932).

7 See *id.* at §§ 422 and 339; see also Restatement (Second) of Contracts § 356.

8 See Restatement (First) of Conflict of Laws § 422 (1934); see also Restatement (First) of Contracts § 339 and Restatement (Second) of Contracts § 356.

9 *Chateau D'Iff Corp. v. City of New York*, 641 N.Y.S.2d 252, 254 (1996).

Because the damages provision in the bidding procedures provided for additional recourse over and above the deposit, the bankruptcy court ignored the liquidated damages provision and sent the case to trial for a determination of actual damages.

The bankruptcy court's decision in *Brown v. BMC* to ignore the liquidated damages provision fits with the general rule of liquidated damages, which must be a reasonable estimate of actual damages where actual damages are difficult to determine. Where a liquidated damages provision provides for the ability to prove more damages, it would tend to indicate that actual damages could be proven, cutting against the aforementioned nonpredictability factor. Additionally, a provision such as that in *Brown v. BMC* also functions as a penalty by providing a minimum amount recoverable without providing a maximum. By fixing a minimum payment in the instant case, the liquidation clause acts as a penalty for not performing

while still providing Brown with the ability to recover additional damages over and above the deposit amount.

## Conclusion

If there is one overarching lesson that can be learned from *Brown v. BMC*, it is that bankruptcy proceedings do not operate in a bubble. The law in bankruptcy proceedings may often evolve on its own; however, practitioners need to be aware of other areas of law that may be applicable. In particular, practitioners should take care in drafting bidding procedures for § 363 sales to ensure that the terms therein comply with local contract law. In determining the amount of a break-up fee or similar good-faith deposit of a successful bidder, practitioners should keep in mind the principles of liquidated damages and the importance of reasonably estimating the amount of damages that may ultimately be incurred in the event the successful bidder fails to close. **abi**

Copyright 2013  
American Bankruptcy Institute.  
Please contact ABI at (703) 739-0800 for reprint permission.