IT IS ORDERED as set forth below:

Date: April 04, 2008

Paul W. Bonapfel
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN THE MATTER OF:	:	CASE NUMBER: A06-62557-PWB
GALLERIA INVESTMENTS LLC,	:	
	:	IN PROCEEDINGS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE
Debtor.	:	
GALLERIA INVESTMENTS, LLC,	:	
Movant	:	
v.	:	CONTESTED MATTER
HONG DUCK, LLC, and IMEDRA #415 FAMILY LIMITED PARTNERSHIP,	:	
Respondents.	:	

ORDER

Hong Duck LLC ("Hong Duck") agreed to purchase the real property of Galleria Investments LLC (the "Debtor") pursuant to contract terms that the Court approved in two orders. The first authorized bidding procedures for the auction and sale of the property pursuant to 11

U.S.C. § 363(b); the second authorized the sale to Hong Duck at the conclusion of the sale process conducted in accordance with those procedures. The bidding procedures order approved Hong Duck as the "stalking horse" purchaser and committed the Debtor to pay a $75,000 stalking horse fee to Hong Duck if Hong Duck was not approved as the successful bidder. The bidding procedures order provided for the sale of the property to the successful bidder at the auction, subject to the Court's final approval, pursuant to a contract with the same material terms and conditions (with an appropriate adjustment to the purchase price) as the contract that Hong Duck had executed in which it agreed to purchase the property. The contract terms included a provision for the Debtor to retain, as liquidated damages, the $1,000,000 earnest money deposit that Hong Duck made if it failed to close in accordance with the contract.

Hong Duck was the successful bidder at the auction. After a final hearing on the sale, the Court approved the sale to Hong Duck pursuant to a contract executed in accordance with the approved bidding procedures. The Court also approved a back-up contract with Imedra #415 Family Limited Partnership ("Imedra") for $100,000 less than the Hong Duck bid. Hong Duck did not close by the time the contract required, and the Debtor sold the property to Imedra.

In this proceeding, the Debtor seeks determinations that it is entitled to retain the earnest money as liquidated damages and that it is not obligated to pay the stalking horse fee because Hong Duck was the successful bidder but failed to close.[1] Hong Duck contends that the Debtor cannot

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[1]This proceeding is a contested matter initiated by the Debtor's filing of its "Motion for Order (1) Authorizing Debtor to Retain Earnest Money as Liquidated Damages; (2) Declaring that no Stalking Horse Fee is Payable to Hong Duck, LLC or to its Assignee; and (3) Declaring that Imedra #415 Family Limited Partnership has no Right to Recover any Portion of the Stalking Horse Fee Escrow." [114]. Hong Duck asserted its defenses and sought return of the earnest money and payment of the stalking horse fee in its "Cross-motion for Order (1) Denying Debtor's Motion to Retain Earnest Money, (2) Adjudicating the Earnest Money Provision in the Stalking Horse Purchase Agreement as an Unenforceable Penalty and (3) Refunding Hond Duck, LLC its Earnest Money Deposit Less Actual Damages Suffered by Debtor." [Doc. No. 141]. Although resolution

retain the earnest money because the liquidated damages provision is an unenforceable penalty under Georgia law and because, in any event, it was not obligated to close due to the Debtor's failure to comply with certain conditions of the contract. Hong Duck contends that it is entitled to payment of the stalking horse fee because it was not obligated to close and because the Debtor sold the property to Imedra following the Court's approval of Hong Duck as the successful bidder at the auction. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O) over which the District Court has jurisdiction pursuant to 28 U.S.C. § 1334 and which this Court has authority to hear and determine pursuant to 28 U.S.C. § 157(a) and Local Rule 83.7, NDGa.

Both Hong Duck and the Debtor filed motions for summary judgment, but Hong Duck's motion is limited to the legal question of whether the provision for the retention of the earnest money is an unenforceable penalty. The Debtor's motion seeks judgment in its favor on all issues. In the procedural posture of this case and in the context of prior proceedings relating to this dispute, the Court deems it appropriate to decline to consider at this time any issues other than the legal questions relating to the validity of the liquidated damages provision. In this regard, the Court had understood that the parties desired to present legal issues relating to the enforceability of the liquidated damages initially and then to conduct further proceedings, including discovery, with regard to any remaining issues, if the Court's ruling on the liquidated damages issue was not dispositive. The Court accepts Hong Duck's position that, consequently, it has not had a full and

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of the dispute would ordinarily require an adversary proceeding, FED. R. BANKR. P. 7001, the parties have agreed that the Court may determine the controversy without one. Parties may, of course, waive the requirement of a formal adversary proceeding.

The Debtor's motion also sought a determination that Imedra is not entitled to reduce its purchase price by $75,000, a position Imedra took in view of the Debtor's position that it did not have to pay a stalking horse fee to Hong Duck. The Debtor has advised the Court that Imedra and the Debtor have settled their dispute, and this Order does not address that controversy. Debtor Brief, n. 1. [160].

fair opportunity to develop the evidence relating to its contentions that it was not obligated to close. Accordingly, the Court will deny the Debtor's motion for summary judgment to the extent that it seeks a ruling that, as a matter of law, Hong Duck was obligated to close.[2] This Order, therefore, deals with the limited issue of whether the damages provision of the purchase agreement executed by the Debtor and Hong Duck is an enforceable liquidated damages provision or an unenforceable penalty.

I. Factual Background

The facts with regard to the liquidated damages issue are either admitted[3] or, if not expressly admitted, are a matter of record. The Court's findings of fact consist of those facts that are set forth in the parties' statements of undisputed facts that the opposing party admits in its response and other matters of record as set forth herein.

The Debtor is a Georgia Limited Liability Company formed in February 2004 for the purpose of acquiring and developing a retail shopping center located at 1291 Old Peachtree Road, Duluth, Georgia (the "Property"). The Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code on March 6, 2006. The Debtor continues as debtor in possession in this case.

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[2]In doing so, the Court deems it appropriate to comment on Hong Duck's assertions that it was not obligated to close because of the Debtor's defaults. The Debtor has characterized these defenses as a "smokescreen." [Debtor Reply Brief at 14, Doc. No. 177]. This characterization may actually be generous to Hong Duck. Although the record before the Court appears to raise the possibility of material issues of fact concerning these defenses that could preclude summary judgment, the record and prior proceedings tend to belie the contention that any material breaches existed. The Court currently sees, at best, a hint of a puff of smoke. The Court will not deny Hong Duck its rights to a full and fair development of the facts and presentation of evidence to support its defenses. But there must be evidentiary fuel for a fire. FED. R. BANKR. P. 9011.

[3]The Debtor submitted a statement of undisputed material facts that has 105 separate paragraphs with somewhat detailed facts. [161]. Hong Duck has admitted all but 17 of them. [173]. Similarly, the Debtor has admitted [Doc. No. 170] most of the facts that Hong Duck presented in its statement of material facts. [157].

The bankruptcy filing stayed a scheduled foreclosure sale by Georgian Bank (the "Bank"), holder of a note and senior security deed on the Property. The Bank's claim – later paid from the proceeds of the sale to Imedra – was for approximately $17,243,000.[4] In addition, the Bank claimed an entitlement to statutory attorney fees of approximately $1,700,000 and default interest of approximately $250,000, claims that the Bank ultimately waived because the Debtor satisfied certain conditions including payment of the Bank's remaining claim in full within an agreed-upon deadline. Timely payment of the Bank, of course, required sale of the Property on or before the payment deadline.

Other significant parties in interest in this case include Ordner Construction Co., Inc. ("Ordner"), which asserted a claim for $1,527,000 based on a materialman's lien on the Property and which had disputes with the Bank that exposed the Bank to potential liability or reduction of its recovery from the Property; Continental Development Group, LLC ("Continental"), which asserted a claim for approximately $1,200,000, secured by a recorded deed to secure debt; and Assiplaza Sugarloaf, Inc. ("Assiplaza"), the shopping center's major tenant under a prepetition lease with terms some have characterized as unfavorable to the Debtor.

At the time the bankruptcy case was filed, Glass Ratner Management and Realty Advisors, LLC ("Glass Ratner"), was the receiver for the Property pursuant to an order entered by the Superior Court of Gwinnett County, Georgia. On March 15, 2006, this Court entered an Order that provided for the receiver, as a custodian, to continue to manage the Property while the Debtor sought to effect its sale.

From the early stages of this case, the Debtor, in consultation with the Bank, solicited offers for the sale of the Property. In April 2006 the Debtor negotiated and signed a term sheet for

[4]This figure represents principal and interest at the non-default rate as of July 6, 2006.

the sale of the Property to Shatto Corporation ("Shatto") for $20,300,000, free and clear of all liens and encumbrances. The term sheet contemplated (1) a $1 million earnest money deposit; (2) termination of the Assiplaza lease and a sale free and clear of Assiplaza's leasehold interest pursuant to 11 U.S.C. § 363(f); (3) an option for Shatto to acquire the Bank's note and security deed so that it could conduct a foreclosure sale and negotiate new leases with all lessees that were subordinate to the Bank's lien; (4) creation of a $600,000 escrow for fees incurred by Shatto to remove Assiplaza from its premises in the Property; and (5) approval of Shatto as a stalking horse bidder with a stalking horse fee of $75,000. The term sheet was not to be treated as a final offer until execution of a purchase and sale agreement.

Prior to the execution of a purchase and sale agreement with Shatto, Karen Chong, an interest holder in the Debtor, and Linda Kim, the Property's project manager, began negotiations with John Kim and Ivy Chong, who had expressed an interest in the Property. John Kim and Ivy Chong eventually formed Hong Duck as the acquisition vehicle.

Karen Chong and Linda Kim, on behalf of the Debtor, and John Kim and Ivy Chong, on behalf of Hong Duck, negotiated a term sheet containing the same terms as the Shatto term sheet, but with a purchase price of $21.1 million and a proposed earnest money deposit of $500,000. Further negotiations resulted in Hong Duck increasing its gross purchase price to $21.5 million. Debtor's counsel circulated the proposed Hong Duck term sheet to counsel for the Bank, who indicated that the Bank was inclined to support the Shatto bid and that earnest money of $1 million was important. After the Debtor's counsel informed Hong Duck's counsel of the Bank's position, on May 5, 2006, Hong Duck submitted a revised term sheet that increased the earnest money deposit to $1 million.

After further negotiations, the Debtor and Hong Duck executed a Purchase and Sale

Agreement (the "Stalking Horse Agreement")[5] on May 11, 2006. In connection with execution of the Stalking Horse Agreement, Hong Duck submitted a deposit in the amount of $1 million to be held in trust by the Debtor's attorney.

With respect to earnest money, paragraph 2 of the Stalking Horse Agreement provides:

> 2. EARNEST MONEY. Within three (3) business days after the execution by Seller and Purchaser of this Agreement, Purchaser shall deposit One Million Dollars ($1,000,000.00) (the "Earnest Money") with Lamberth, Cifelli, Stokes & Stout, P.A., ("Escrow Agent") to be placed in an interest bearing account. The Earnest Money shall be refunded to Purchaser in full, together with all accrued interest thereon, if (i) the Bankruptcy Court for the Northern District of Georgia (the "Bankruptcy Court") does not approve this Agreement; (ii) the Bankruptcy Court conducts an auction of the Property and the Property is sold to a party other than Purchaser; (iii) the Bankruptcy Court conducts an auction and Purchaser is not selected as the successful bidder or the secondary bidder; (iv) Seller defaults hereunder; (v) the conditions to Purchasers's obligation to close are not satisfied or waived by Purchaser; or (vi) as otherwise set forth herein. All interest earned on the Earnest Money shall accrue to the benefit of Purchaser. Disbursement of the Earnest Money to Seller shall only be made by order of the Bankruptcy Court.

Paragraph 14 of Stalking Horse Agreement deals with disposition of the earnest money in the event of a default:

> 14. DEFAULT REMEDIES. In the event the sale is not closed because of Seller's inability, failure, or refusal to perform any of Seller's obligations herein, Purchaser shall have the right to cancel this Agreement in which event the Escrow Agent shall return the Earnest Money to Purchaser, or Purchaser may seek specific performance of this Agreement. Subject to the satisfaction or waiver of any conditions precedent to Purchaser's obligation to Close, in the event Purchase should fail to consummate the transaction contemplated herein for any reason except Seller's default, Seller shall, as its sole and exclusive remedy hereunder, be entitled to receive the Earnest Money, such sum being agreed upon as liquidated damages for the failure of Purchaser to perform the duties, liabilities and obligations imposed upon it by the terms and provisions of this Agreement and because of the difficulty, inconvenience and uncertainly of ascertaining actual damages, and no other damages, rights or remedies shall in any case be collectible, enforceable or available to Seller

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[5]The Stalking Horse Agreement is attached as Exhibit 5 to the Debtor's Statement of Material Facts. [161].

> other than as provided in this paragraph. Seller agrees to accept and take the Earnest Money as its total damages (subject to the liens of Georgian Bank to the extent provided under applicable non-bankruptcy law) and relief hereunder in such event and shall have no other cause of action against Purchaser. It is the express intent of this paragraph that there shall be no personal liability whatsoever on the part of Purchaser under this Agreement (except for Purchaser's failure to deliver the Earnest Money to Escrow Agent as required hereunder) and only the Earnest Money may serve as security for any payment, including, without limitation, the Purchase Price. Without in any way limiting the generality of the foregoing, but in furtherance thereof, under no circumstances shall Seller be entitled to specific performance as a remedy under this Agreement.

The Stalking Horse Agreement provided that Hong Duck would receive a fee of $75,000 if the Court approved a sale of the Property to a higher or better bidder at auction (Stalking Horse Agreement, ¶ 13).

The Stalking Horse Agreement was subject to Bankruptcy Court approval and to higher and better offers. On May 19, 2006, the Debtor filed its "Motion for Order (1) Approving Sale Free and Clear of Liens, Claims, and Encumbrances under Section 363 of the Bankruptcy Code; (2) Approving Assumption and Assignment of Certain Executory Contracts and Unexpired Leases Pursuant to Section 365 of the Bankruptcy Code; (3) Approving Procedures for Sale, Including Terms for Submission of Competing Offers and Auction Procedures; and (4) Approving Procedures Regarding Assumption and Assignment of Executory Contracts and Unexpired Leases." In this motion, the Debtor sought approval of the Stalking Horse Agreement with Hong Duck and bidding procedures to govern the solicitation of other bids, the terms of sale, and the conduct of the auction.

The major tenant, Assiplaza, objected to sale of the shopping center free and clear of its leasehold interest and claimed the right under 11 U.S.C. § 365(h) to remain in possession if the Debtor rejected the lease. At the hearing on approval of the bidding procedures and the Stalking Horse Agreement, the Debtor announced that it desired to solicit bids to purchase the Property subject to the lease as well as bids to purchase free and clear of it, as the Hong Duck agreement contemplated. A sale free and clear of the lease became known as "Option A," and a sale subject to the lease became known as "Option B."

Following the hearing, the Court entered an order that authorized the Stalking Horse Agreement with Hong Duck and approved bidding procedures as modified during the course of the hearing. [83]. The bidding procedures provided for the Debtor to conduct an auction at which qualified bidders could bid to purchase the Property in accordance with Option A or Option B or both. The bidding procedures provided for the successful bidder to execute a contract with the same material terms as the agreement with Hong Duck, modified in the case of an Option B bid to take account of the fact that the sale would be subject to the Assiplaza lease.

The auction was conducted in accordance with the bidding procedures. Hong Duck was the highest Option B bidder, with a purchase price of $20,200,000. Imedra was the next highest Option B bidder, and it agreed to purchase the Property for $ 20,100,000 in the event that Hong Duck did not timely close. Shatto submitted the highest and best Option A bid that would net the estate $22,025,000. The Debtor elected to accept the Option B bids in view of uncertainties of litigation with Assiplaza and its potential claim for damages even if the Debtor were successful in selling free and clear of the Assiplaza lease.

The Debtor presented the bids it had accepted to the Court at the hearing on approval of the sale and requested that the Court approve the sale to Hong Duck in accordance with the bidding procedures. At this hearing, the Court rejected Imedra's request to reopen the bidding to permit it to make a higher bid than Hong Duck's. The Court approved Imedra's existing bid as a back-up bid if Hong Duck failed to close.

The Debtor and the Bank agreed to fix the amount of the Bank's claim and negotiated terms whereby the Bank would be paid at closing. The Bank and the Debtor further agreed that, based upon the satisfaction of certain conditions, the Bank would waive its right to assert the full default rate interest and its unsecured claim for statutory attorney's fees. The conditions included the waiver by Ordner of any claims against the Bank and timely payment of the Bank's remaining claim which, in turn, required timely closing of the sale of the Property. The Bank's concessions, if the conditions were satisfied, would result in reduction of potential claims against the Debtor by approximately $2 million.

On July 12, 2006, the Court entered an Order approving the proposed sale to Hong Duck pursuant to the terms of the Option B Agreement that was attached to the Sale Order [Doc. No. 100]. Paragraph 14 of the Option B Agreement contained the same language as paragraph 14 of the Stalking Horse Agreement quoted above with regard to the Debtor's right to retain the earnest money deposit as liquidated damages in the event Hong Duck failed to timely close the sale. (July 12, 2006 Order, Purchase and Sale Agreement, ¶ 14).

The terms of the Purchase and Sale Agreement approved by the Court (and attached to the Sale Order), required Hong Duck to close no later than July 27, 2006. (Purchase and Sale Agreement, ¶ 17). On the original closing date of July 27, 2006, Hong Duck informed the Debtor that it was unable to close the transaction, due to Hong Duck's inability to obtain necessary financing of the purchase price. Hong Duck sought an extension of time from the Debtor and the Bank, but the Bank refused. The Debtor notified Imedra, the backup bidder, of Hong Duck's failure to close by the July 27, 2006 closing deadline. During this time, Hong Duck continued to communicate with Debtor's counsel regarding Hong Duck's efforts to obtain the necessary financing to close the transaction. On August 4, 2006, after the Court[6] refused to interfere with the proposed sale of the Property to Imedra,[7] the Debtor closed the transaction with Imedra.

II. Conclusions of Law

The legal issue now before the Court based on the undisputed material facts as set forth herein is whether the retention of the $1 million earnest money is an unenforceable penalty. Hong Duck asserts that the money should be returned to it because the contractual provision for its retention is an unenforceable penalty under Georgia law, which is the governing law under the contract's choice of law provision. The Debtor asserts that the provision is enforceable under both federal bankruptcy law and under Georgia law.

A. The Bankruptcy Sale Process and Finality of Orders

Consideration of the enforcement of a liquidated damages provision arising from an agreement for the sale of an asset of the bankruptcy estate and related bidding procedures that the Court has approved in an order entered after notice and a hearing requires a review of the general context in which bankruptcy sales take place as well as the specific circumstances of the sale in question. In general, § 363(b) authorizes the sale of estate property, other than in the ordinary course of business, after notice and a hearing. The reason for the requirement of notice and a hearing is to provide parties in interest an opportunity to be heard and to insure that the contemplated course of action is in the best interest of the estate.

When a § 363(b) sale is proposed in a chapter 11 case, it is typically because the prospects for a feasible reorganization of the debtor as a going concern are not good. The estate

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[6]Bankruptcy Judge Mary Grace Diehl heard and determined Hong Duck's emergency request.

[7]Order Denying Temporary Restraining Order, Adv. No. 06-6340 [3].

often faces continuing losses from operations and substantial uncertainty as to whether, and if so when, it can achieve profitability and a sufficiently positive cash flow to permit it to service its secured debt. The debtor's financial distress, together with market conditions that may be a significant factor in causing the financial distress, raise concerns about the value of the debtor's assets. In these circumstances, a debtor who cannot arrange for a prompt and effective sale of its assets to satisfy the secured lender risks the termination of the automatic stay to permit the secured lender to proceed with foreclosure, resulting in a distress sale rather than the orderly liquidation of the asset, and consequent loss of value to the estate. Time becomes a critical factor and the enemy of every party in interest in the bankruptcy case. Unless the debtor is generating at least enough money to pay its operating expenses and debt service, every day that goes by without a sale means that the estate will end up with less money and that the secured lender's risk is increasing because the accrual of interest is increasing the amount of the debt.

An inherent conflict exists between the interests of the estate (represented by the debtor as debtor in possession in a chapter 11 case, but whose primary beneficiaries are the general unsecured creditors) and the secured lender. The lender is satisfied with a sale that produces no more than enough to pay its debt and has no interest in achieving the highest possible price for the assets if doing so involves any risk whatsoever. The estate, in contrast, must obtain more than the amount of the secured debt for the property or have nothing left for general creditors or holders of equity interests. Consequently, the estate (and its creditors) will oppose selling the assets at a price that would satisfy only the secured lender and attempt to obtain a higher price, despite any risk of doing so.

It is the task of the bankruptcy court to balance the competing interests. The court must protect the secured lender while at the same time providing the estate an opportunity to maximize the value of its asset. In many instances, the parties themselves resolve the tension through negotiations that result in an acceptable solution to the problem. Regardless of whether the court itself resolves the conflict or approves a negotiated agreement reached by the parties, a frequent component of the solution is the establishment of deadlines relating to the marketing and sale of the property and various adverse consequences to the estate if the deadlines are not met.

For all of these reasons, all of the parties in interest in a bankruptcy case have a vital interest in making sure that a potential purchaser of the estate's assets will close the transaction. Disaster may easily result for the estate if, after the bidding, the highest bidder fails to purchase. Other bidders have moved on to the next deal, time and money have been lost because the process has to start over, and failure to effect the sale within the deadline may result in foreclosure and a distress sale that eliminates or reduces the recovery for the estate. A lender, too, faces potential loss if a sale falls through and must deal with continuing risk.

All of these considerations lead the parties in a bankruptcy case to seek to minimize the risks of disaster through approved bidding procedures and terms and conditions of sale that are designed to insure that a potential purchaser of assets from the bankruptcy estate is a serious bidder with the financial ability to close the transaction and will timely do so and that the estate (and, derivatively, its creditors) will have an adequate alternative remedy if the purchaser does not. Particularly in the context of a § 363(b) sale, "cash is king." Certainty is a paramount concern for all the constituencies in the case that governs their positions and the concessions they may be willing to make. The single most effective way to accomplish all of these critical objectives is to require substantial earnest money that the estate retains if the purchaser fails to perform.

The facts of this case illustrate the operation of these general principles. The Debtor came into bankruptcy with a distressed shopping center for which the Superior Court had already appointed a receiver. The Bank was poised to conduct a foreclosure sale when the bankruptcy case was filed. The Property did not generate enough revenue to pay debt service. The only solution for the estate and its creditors was an orderly liquidation of the shopping center through a § 363(b) sale. Taking into account their competing interests and their own business objectives and evaluations, the Debtor, the Bank, and other creditors agreed on bidding procedures for the marketing of the Property, the solicitation of bids, and the conduct of an auction, and a deadline for the sale to take place. Importantly, the Bank agreed to waive substantial claims of some $2 million on conditions that included prompt payment and a waiver of certain potential claims by Ordner. The critical event to which all of these agreements were tied was the sale of the Property by the deadline to which everyone, including Hong Duck, agreed.

The parties in the case agreed to propose bidding procedures that incorporated the stalking horse element discussed above. The process began with the negotiation and execution of the Stalking Horse Agreement that would serve as the basis for other bidders to make competing bids on the same terms at an auction; it included the requirement of earnest money of $1,000,000 and provided for the Debtor to retain it if the purchaser failed to close. And it provided a $75,000 stalking horse fee as an inducement to the purchaser to agree to purchase subject to higher bids. Hong Duck agreed to these terms.

When the bidding procedures and Stalking Horse Agreement came before the Court, further negotiations and court proceedings led to modifications in the procedures. The bidding procedures were changed to provide for the solicitation of Option B bids as well as Option A bids, and the terms of the Stalking Horse Agreement to which Hong Duck had already agreed became the basis for the terms of a sale under either alternative. The earnest money requirement remained a material term under both options. Hong Duck received authorization to submit an Option B bid if it chose and to have its earnest money deposit applied to either type of bid, and Hong Duck was to receive the stalking horse fee if it was not the successful bidder regardless of whether the estate selected an Option B bid. The Court entered an order approving all of the foregoing, among other things. [83]. Hong Duck, at a minimum, implicitly accepted these terms and conditions at the hearing and expressly did so by its conduct in participating in the auction process and submitting the highest Option B bid that the Debtor accepted and the Court eventually approved.

Having set the context in which this dispute must be analyzed, the Court turns to the legal issues.

Section 363(b) does not, by its terms, require an order from the bankruptcy court as a condition to a valid sale of assets of a bankruptcy estate out of the ordinary course of business. All it requires is notice and a hearing. If the trustee (or debtor in possession, in a chapter 11 case) provides proper notice in accordance with FED. R. BANKR. P. 6004 and no objections are interposed, the trustee may proceed with the sale as proposed without the necessity of judicial intervention. If an objection is made, the bankruptcy court conducts a hearing to consider it and rules on the objection. Obviously, in such a situation, an order resolving the objection is required.

Nevertheless, the practice has developed under the Bankruptcy Code under which the trustee seeks affirmative court approval in advance: of a proposed sale of property; of the proposed terms and conditions of the sale; of the estate's commitment to pay a stalking horse fee or other inducements to an initial bidder; of the procedures to be utilized in marketing the property, making information about it available to prospective bidders, soliciting bids and determining whether bidders are qualified (*i.e.,* financially capable of consummating the proposed transaction in accordance with its terms and conditions), and conducting an auction if other bids are received; and obtaining final court approval for the sale. Among other things, prior judicial approval of all of the foregoing lays the foundation for obtaining a determination that the sale is in good faith under § 363(m), a vital part of an order authorizing a sale from the purchaser's standpoint in order to avoid later challenges and to bring finality to the transaction notwithstanding an appeal, unless the sale is stayed.

This practice provides all parties in interest in the bankruptcy case the opportunity to be heard and brings the essential ingredient of certainty to the transaction. Whether the result of give and take negotiations or the court's resolution of disputes over sales procedures, bidding incentives, terms and conditions of sale, or timing, the court's entry of an order authorizing and approving the proposed sale and the sales procedures establishes definitive rules for the transaction, its terms and conditions, the procedures leading up to the sale, and its consummation. Everyone in the case knows that the proposed procedures, the terms and conditions of the sale, and the sale itself in accordance with those procedures have received judicial approval and that the transaction can take place as authorized. Similarly, prospective purchasers know what they have to do and what is expected of them. Nothing makes a potential purchaser participate in the process; if it does not like any aspect of the rules, it has no obligation to submit a bid.

In effect, a motion seeking approval of a proposed sale of assets, the terms and conditions of the sale, and the procedures to be followed in soliciting bids seeks the equivalent of a declaratory judgment that the procedures, if properly followed, will permit the sale to take place with a determination under § 363(m) that it is in good faith and that the contract for the sale of the Property is enforceable in accordance with its terms and the bidding procedures.

A bankruptcy case,[8] unlike ordinary civil litigation, does not always involve a discrete

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[8]The court notes that it is observing the distinction between a bankruptcy *case*, which is initiated by the filing of a petition and is the whole of all of the matters that take place with regard to administration of a debtor's bankruptcy estate, and a *proceeding,* which is a specific litigation

controversy between specifically identified parties. Sometimes, as in this instance, a proceeding before the bankruptcy court begins in one way and ends in another. Moreover, an entity potentially affected by an order of a bankruptcy court may not technically be a party to the proceeding in which the order was entered, or even a party in interest in the case, with standing to object to the order.

A prospective bidder at a bankruptcy sale conducted in accordance with judicially approved procedures is in precisely such a situation. Obviously, a prospective bidder cannot be bound by the entry of an order establishing the terms and conditions of a sale in the sense that a party in civil litigation is bound by the court's judgment in such litigation. But when the prospective bidder participates in the sale process in accordance with that order, the prospective bidder becomes an actual bidder who, by entering the case and participating in it, has submitted itself to the bankruptcy court's jurisdiction and must necessarily be treated as accepting the terms of the order such that it is bound by the order to the same extent as parties in interest are.

Because the sale process in this case, as outlined in this Order, like many other sale procedures, contemplated the entry of a series of orders and continuing judicial supervision of the sales process and the terms and conditions of the sale, each order entered as the process unfolded must be considered as a binding order with regard to any issue the order addresses, unless modified for good cause shown. If an entity, such as a prospective bidder, enters in the middle of, or even at the end of, such a process, it cannot expect to do so without being bound by and subject to any previous orders that are in effect at the time its participation begins. To the contrary, a prospective bidder who becomes an actual bidder, and especially one who becomes the successful bidder, effectively becomes a party for purposes of determining the validity and effect of previous orders

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matter initiated by the filing of a complaint initiating an adversary proceeding or a motion initiating a contested matter. An objection to a paper or pleading filed in the bankruptcy case, such as an objection to a notice of a proposed sale, may also initiate a contested matter.

governing the sales process in which it has elected to participate. It cannot participate and then contend that, because it was not a party at the time of the entry of a previous order, the normal rules applicable to the effect of a prior order are not binding on it.

An order approving bidding procedures thus becomes binding on a bidder.[9] Absent a determination by the Court that it has somehow been mislead or has overlooked an unusual provision or other compelling circumstances, an order approving bidding procedures is binding on the parties in the case and on anyone who elects to participate in the sale process, especially the entity that submits the successful bid and thereby agrees to the terms and conditions that have been judicially approved. Indeed, Hong Duck took advantage of this principle in this case when the Court, at the hearing on approval of Hong Duck's bid, refused to change the bidding procedures to permit Imedra to submit a higher Option B bid after the time permitted by the approved bidding procedures.[10] *A fortiori,* an order at the end of the process approving the specific bid has the same effect of binding all the parties in the case and the purchaser to the approved terms and conditions.

No circumstances exist here to cause the Court to modify its orders or relieve anyone from their binding effect, including determination of the enforceability of the terms of the sale. The provisions for the earnest money deposit and the Debtor's retention of it if Hong Duck failed to close were obviously material provisions that the Court and everyone in the case were aware of. The existence and amount of these provisions were the subject of discussion and negotiations between the Debtor and Hong Duck, which agreed to raise the earnest money from $500,000 to

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[9]*Cf.*, Canzano, Trustee of the J & B Realty Trust v. Ragosa (*In re* Colarusso), 382 F.3d 51 (1st Cir. 2004).

[10]Of course, the provision in the bidding procedures for the Court's approval of a bid preserved the Court's authority to accept even a late bid if appropriate to protect the estate from a significant loss.

$1,000,000 in order to assure selection as the stalking horse bidder over a competing bidder who had agreed to deposit $1,000,000. The deadline for closing was obviously critical because payment of the Bank by the deadline was critical to the estate to achieve a reduction in the Bank's claim by some $2 million.

The Court entered an order approving procedures that incorporated contractual provisions for the Debtor's retention of an earnest money deposit of $1,000,000 if the purchaser failed to timely close in accordance with the deadline. Hong Duck and others submitted bids in accordance with that order and the procedures it approved. Each of those bids constituted an offer to purchase in accordance with terms and conditions that the Debtor and Hong Duck initially negotiated and that the Court approved. The Court entered a further order that specifically approved the sale to Hong Duck in accordance with a purchase agreement that contained the same material terms and conditions that the Court had previously approved. Those two orders became, and are, final, binding determinations of the terms and conditions of a judicially approved sale and, of necessity, those terms and conditions are valid and enforceable.

The inclusion of a boilerplate provision in the approved contract that Georgia law governs does not change this result. Retention of the earnest money as liquidated damages was a material part of the transaction that the Court approved at the beginning and at the end of the process. Neither the parties in this bankruptcy case nor the Court expected that this material provision would be subject to challenge under Georgia law, and the judicial approval of the term precludes the assertion that another provision of the contract renders it unenforceable. Georgia law may provide appropriate rules for interpretation of the contract and for determining consequences for which the contract does not clearly provide. But Georgia law cannot be invoked to invalidate a clear provision that is a material and critical element of the transaction. A prospective purchaser in a bankruptcy sale who thinks that it is not bound by a judicially approved term for the estate's retention of earnest money if it fails to close because it is unenforceable under state law applicable under a choice of law provision should not bid. It cannot later claim that its commitment to such a term, judicially authorized and necessarily relied on by the parties in the case, is unenforceable.

The Court emphasizes that the rule cannot be otherwise. The bankruptcy process demands certainty in connection with the liquidation of assets. The system cannot tolerate challenges to judicially approved terms and conditions of a sale that serve important and recognized bankruptcy objectives and on which all parties in the bankruptcy case have justifiably relied. Prospective purchasers desiring to participate in a § 363 sale must have their eyes open and must live with the consequences. A purchaser cannot make a commitment to purchase an asset from a bankruptcy estate on judicially approved terms and silently reserve a right to challenge the enforceability of the terms to which it committed.

Hong Duck has moved for relief from the Court's orders under FED. R. CIV. P. 60(b), *applicable under* FED. R. BANKR. P. 9024. The Court sees no basis for such relief. No mistake, inadvertence, surprise, excusable neglect, newly discovered evidence, or fraud, misrepresentation, or other misconduct by an adverse party exists. Hong Duck suggests only that the orders should be corrected because they approve terms and conditions that are unenforceable under Georgia law. The Court would have refused to require the elimination of those provisions at the time it entered the Orders and it does so now. Hong Duck's motion for relief under Rule 60(b) is denied.

Based on the foregoing, the Court concludes, as a matter of law based on the undisputed material facts shown in the record, that Hong Duck is bound by the terms and conditions of the agreements it executed, including the provision for the Debtor to retain the earnest money deposit as liquidated damages on the conditions set forth therein, in accordance with this Court's orders that authorized and approved those terms and conditions.

B. <u>Enforceability of the Liquidated Damages Provision Under Georgia Law</u>

Alternatively, for reasons discussed below, the Court rejects Hong Duck's contention that the liquidated damages provision is an unenforceable penalty under Georgia law.

The enforceability of a liquidated damages provision in a contract is a question of law for the court. *Martin v. Lott*, 144 Ga. 660, 87 S.E. 902 (1916). Under Georgia law, "If the parties agree in their contract what the damages for a breach shall be, they are said to be liquidated and, unless the agreement violates some principle of law, the parties are bound thereby." O.C.G.A. § 13-6-7.

Under Georgia law, in order to determine whether a contract provision is enforceable as liquidated damages, a court must analyze whether the following factors are present:

> First the injury caused by the breach must be difficult or impossible of accurate estimation; second, the parties must intend to provide for damages rather than for a penalty; and third, the sum stipulated must be a reasonable pre-estimate of the probable loss.

Southeastern Land Fund, Inc. v. Real Estate World, Inc., 237 Ga. 227, 230, 227 S.E.2d 340, 343 (1976). The burden is on the defaulting party to show that one of the elements does not exist. *Liberty Life Ins. Co. v. Thomas B. Hartley Const. Co., Inc.*, 258 Ga. 808, 809, 375 S.E.2d 222, 224 (1989). In the context of a summary judgment determination, the defaulting party must demonstrate the existence of a dispute of material fact, the resolution of which in its favor would establish the absence of one of these elements. As set forth below, based upon an application of these three factors to the undisputed material facts in this matter, the Court concludes that the liquidated damages provision is enforceable and that the Debtor is entitled to summary judgment on this issue.

1. Whether the injury is difficult or impossible to accurately estimate

A liquidated damages provision is an unenforceable penalty if the injury caused by a breach is difficult or impossible to accurately estimate. For purposes of making this determination, the Court's examination must focus on the time at which the contract was executed, not the time the breach occurred. *Joyce's Submarine Sandwiches, Inc. v. California Public Empl. Retirement Sys.*, 195 Ga.App. 748, 395 S.E.2d 257 (1990); *Adams v. D&D Leasing Co. of Georgia, Inc.*, 191 Ga.App. 121, 123, 381 S.E.2d 94, 96 (1989).

The gravamen of Hong Duck's argument is that, at the time it executed the purchase agreement as the successful bidder, the Debtor had a back-up contract with Imedra for only $100,000 less than the price Hong Duck had agreed to pay and that the existence of the back-up contract limited damages at a maximum of $100,000. Because the amount of damages was known when it executed the contract, Hong Duck concludes, no need for estimation existed, and the liquidated damages provision must be an unenforceable penalty.

An important premise of Hong Duck's argument is that the proper time for evaluating the liquidated damages provision is the time that it executed the final purchase contract for its purchase under the Option B alternative. In this regard, Hong Duck asserts that it is not bound by what it originally signed (and what became the Option A alternative).

The premise is flawed. The liquidated damages provision was negotiated and was a material term of the sale from the outset, when there was no back-up bid. The provision was included as a material term of *any* sale when the Court approved the bidding procedures that contemplated both Option A and Option B bids. Even at this later time, there was still no back-up bid or, in fact, any other bids. The limited damages that Hong Duck postulates could not possibly have been known either when the contract term originated as a result of execution of the Stalking

Horse Agreement between Hong Duck and the Debtor or when the Court approved that term as part of the bidding procedures.

Even if the Court accepts the premise that the proper time to assess the liquidated damages provision is when Hong Duck executed the final contract, it does not follow that the damages were then known. Although the Debtor obtained Imedra's back-up bid in connection with the acceptance of Hong Duck's Option B bid, the Debtor had no assurance that the back-up contract would close. At that time, therefore, damages were still not definitively established or limited as Hong Duck contends.

The Court concludes that the damages that the Debtor might suffer as a result of Hong Duck's failure to close were difficult or impossible of accurate estimation. In this regard, Ronald Glass, a principal of Glass Ratner carrying out its duties as the receiver, advised the Bank that damages to the Property would be substantial if the Debtor terminated the Assiplaza lease and failed to sell the Property because there would be a loss of rental revenue, loss of tenants, and, as a result, diminished value of the Property as a whole. Mr. Glass estimated that damages would exceed $1 million, but that a $1 million earnest money deposit was reasonable under the circumstances.

Even without regard to Mr. Glass's analysis, it is clear that the failure to close the sale could result in substantial damage to the Debtor in excess of $1 million. If the deal with Imedra did not close (after the deal with Hong Duck had already failed), the Debtor likely would have lost the ability to achieve the Bank's waiver of some $2 million of its claim because the Debtor could not have made the timely payment that was one of the conditions for the waiver. The Debtor's failure to consummate a sale would have tested the Bank's patience, increased its frustration arising from the inability of the Debtor to pay debt service, and deepened its appropriate concern about whether the Debtor could effect a sale of the Property for enough to satisfy its debt which, of course, increased daily because the Debtor was not even paying interest. Vigorous effort on the part of the Bank to obtain relief from the automatic stay to proceed with foreclosure could have been expected (with consequent increase in the Debtor's and the Bank's attorney's fees) with an unpredictable result. If the sale fell through, the Debtor would have to be concerned about its ability to avoid termination of the automatic stay in view of the provisions of § 362(d)(3) (which provide for relief from the stay in a single asset real estate case if a debtor does not timely commence monthly interest payments or file a plan of reorganization with a reasonable possibility of being confirmed within a reasonable time) and in view of the potential difficulty in any event of convincing the Court (in view of its failure to effect a sale of the Property) that the Property had enough equity to provide adequate protection to the Bank to avoid termination of the stay for cause under § 362(d)(1). In short, without the sale of the Property, a likely prospect for the estate was a distress sale at far less than the bids of Hong Duck and Imedra and potentially not enough to satisfy the Bank's claim. Quantifying the amount of the potential damages that the Debtor could have suffered as a result of Hong Duck's breach is at worst impossible and at best difficult.

The foregoing factors provide ample basis for a conclusion that the damages flowing from Hong Duck's breach were difficult or impossible of accurate estimation, even at the time of the breach or the execution of the purchase agreement after the auction and indisputably at the times of execution of the Stalking Horse Agreement or the Court's approval of the bidding procedures. Hong Duck has not produced any evidence to create a factual issue on this point. The liquidated damages provision does not fail this requirement.

2. Whether the parties intended to provide for damages rather than a penalty

The second prong of the liquidated damages analysis is whether the parties intended to provide for damages rather than a penalty in their agreement. The Court must examine the parties' intent that was manifested at the time that they originally negotiated and agreed to the proposed provision.

Determination of the parties' intent begins with examination of the language of the contract itself. *Hopkins v. Garner & Glover Co.*, 233 Ga.App. 264, 270, 504 S.E.2d 78, 82-83 (1998). The use of the term "liquidated damages" in the contract is evidence of the parties' intent. *See Chandy v. Racetrac Petroleum, Inc.*, 147 Fed.Appx. 811 (11^{th} Cir. 2005) (Provision stating that, in the event of the purchaser's breach in of a contract for the sale of real estate, the "earnest money may be retained by seller as liquidated damages for such a default" shows that the parties "clearly contemplated and intended for the earnest money to be treated as liquidated damages"); *Liberty Life Ins. Co. v. Thomas B. Hartley Constr. Co.*, 258 Ga. 808, 809, 375 S.E.2d 222, 223 (1989).

While Hong Duck is correct that the use of the term "liquidated damages" is not necessarily dispositive, Hong Duck has offered no evidence to contradict the intent of the parties as expressed in the purchase agreement. The fact that the Debtor may have entered into an earlier failed purchase and sale agreement with Continental that provided for liquidated damages of only $1,000 is irrelevant to the Court's inquiry with respect to the bargain struck by the Debtor and Hong Duck. It is undisputed that the Debtor and Hong Duck engaged in thorough and thoughtful negotiations with respect to this provision; that the parties in fact negotiated the size of the earnest money deposit that would serve as liquidated damages; that this provision survived and endured through various permutations; and that the Debtor considered it a crucial element of a bid. These undisputed material facts establish that, as set forth in the contract, the parties intended to provide for damages.

Two other features of the damages provision are relevant to this analysis. Paragraph 14 prohibits the Debtor from seeking specific performance *and* from seeking to impose any personal liability on Hong Duck other than delivery of the earnest money. The absence of any other remedy further indicates that the parties intended the retention of the earnest money to provide compensation to the Debtor for damages in the event of Hong Duck's breach.

The Court concludes, on the basis of the undisputed material facts in this proceeding, that the liquidated damages provision meets the requirement of the second prong of the test for its enforceability.

3. <u>Whether the stipulated sum was a reasonable estimate of probable loss</u>

Finally, the Court must determine whether the stipulated sum was a reasonable pre-estimate of the probable loss caused by the breach of the Agreement. This third requirement seems somewhat inconsistent with the first prong of the tripartite test for the enforceability of liquidated damages. Under the first prong, the injury must be difficult to accurately estimate, whereas under the third prong, the amount stipulated for liquidated damages must be a reasonable pre-estimate of the probable loss.

Essentially, the third requirement calls for a determination that the amount of the liquidated damages cannot be an arbitrary sum. Although it may be difficult to estimate the net loss deriving from a breach (and, indeed, must be to satisfy the first requirement), it is still possible for parties to establish an estimate in the event of breach that is reasonable and with a basis in fact and normal business practices. *See Chandy v. Racetrac Petroleum, Inc.*, Civil Action No. 1:03-cv-2890-RWS (N.D. Ga. Jan. 14, 2005) (slip op.), *aff'd*, 147 Fed.Appx. 811 (11^{th} Cir. 2005) (Third prong of analysis "requires only that the forfeiture figure selected by the parties be based on a deliberate effort by one of them to estimate approximate pecuniary loss should the defaulting party breach, and that the selected sum not be substantially disproportionate to the injury one could reasonably expect to flow from such a default.").

The Court concludes that Hong Duck has not established the existence of a dispute of material fact with regard to whether $1 million is an arbitrary and unreasonable amount for liquidated damages. The $1 million liquidated damages figure represents only 4.95% of the total contract price of $20.2 million. Courts have allowed liquidated damages of up to 10% of the purchase price in real estate cases. *See Chandy v. Racetrac Petroleum, Inc.*, Civil Action No. 1:03-cv-2890-RWS (N.D. Ga. Jan. 14, 2005) (slip op.), *aff'd.*, 147 Fed.Appx. 811 (11th Cir. 2005) (liquidated damages of $220,000 in failed $2 million real estate transaction "appears to be reasonably proportionate to the financial injury one might expect from a breach on the part of the purchaser"); *Liberty Life Ins. Co. Thomas Hartley Constr. Co., Inc.*, 258 Ga. 808, 375 S.E.2d 222 (1989).

The Court does not conclude that a bright line percentage is an appropriate method for determining whether a liquidated damages provision is reasonable, but these cases, coupled with the likelihood that the Debtor likely would have suffered damages in excess of $1 million in the event of a failed sale, cause the Court to conclude that the $1 million sum was a reasonable pre-estimate of probable loss in the event of Hong Duck's breach. The earlier discussion with regard to the difficulty of estimating damages provides ample support for this conclusion. Mr. Glass estimated that damages could exceed $1 million but that earnest money in that amount was reasonable under the circumstances. The potential loss of the Bank's waiver of some $2 million of claims alone shows that damages of $1 million is a generous estimate from Hong Duck's standpoint. Similarly, damages of less than 5% as a consequence of a foreclosure sale is a conservative estimate of potential loss in such an event.

Other than advancing the proposition that the Debtor has been spared from such damages because of the Imedra back-up bid, Hong Duck has produced nothing to contest the amount of the liquidated damages as a reasonable estimate of loss. The Court has rejected Hong Duck's proposition because the analysis of the enforceability of the liquidated damages provision must be based on the situation as reasonably contemplated by the parties at the time of the contract, not at the time of the breach. Indeed, Hong Duck's argument goes further and requires that the estimate of damages must be reasonable when compared to what actually happened. But the law permits parties to contract for liquidated damages precisely because of the difficulty of predicting future events and consequences. Thus, the fact that Imedra's purchase of the property may have limited the Debtor's damages does not establish that liquidated damages of $1 million was not a reasonable estimate of loss if Hong Duck did not.

The Court concludes that, based on the undisputed material facts, the liquidated damages provision meets the third requirement for enforceability.

III. Conclusion

Based on the foregoing, the Court concludes, based on the undisputed material facts established in the record as set forth above, that the liquidated damages provision is enforceable as a matter of law. It is, therefore,

ORDERED that Hong Duck's motion for summary judgment be, and it hereby is, **DENIED**. It is further

ORDERED that the Debtor's motion for summary judgment be, and it hereby is, **GRANTED IN PART and DENIED IN PART**. The Court grants summary judgment in favor of the Debtor that the liquidated damages provision is enforceable as a matter of law. The Court denies, without prejudice, summary judgment in favor of the Debtor on all other issues because consideration of its motion on those issues is premature. It is further

ORDERED and NOTICE IS HEREBY GIVEN that the Court shall hold a scheduling and status conference on **May 6, 2008, at 2:00 p.m.,** in Courtroom 1401, U.S. Courthouse, 75 Spring Street, S.W., Atlanta, Georgia.

End of Order

This Order is not intended for publication.

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