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## Choice of Law & Liquidated Damages Analyses Result in Significant Reduction of Creditor's Claim

*Posted by Jessica Grossarth  
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In the context of an objection to claim proceeding, the Bankruptcy Court (Dabrowski, J.) engaged in choice of law and liquidated damages analyses and as a result disallowed approximately a million dollars of Best Western's claim against the debtor, Whitehall Avenue, LLC ("Debtor").

A few years prior to the bankruptcy filing, the Debtor entered into an agreement with Best Western to operate its Mystic, Connecticut hotel as a Best Western hotel (the "Agreement"). Best Western is an Arizona non-profit corporation operating as a membership organization of hotel owners. After the Chapter 11 was commenced, Best Western filed a proof of claim asserting a claim for \$1,320,739.87 arising out of the Agreement. The claim was comprised of three components: 1) \$116,076.27 for a past due balance owed by the Debtor for unpaid dues, fees and assessments; 2) \$98,136.10 as statutory damages under Arizona law equal to twice the amount of two bounced checks in the amounts of \$7,000 and \$42,068.05; and 3) \$1,106,527.50 for liquidated damages under the Agreement for the Debtor's unauthorized post-termination use of Best Western symbols for a 507 day period.

Preliminarily, the Bankruptcy Court addressed and rejected Best Western's argument that, under Arizona law, issue preclusion precluded the Debtor from re-litigating the validity or amount of the claim because a judgment had already entered against the Debtor's principal. Judge Dabrowski found that because the judgment against the principal was entered in federal court, and not state court, its preclusive effect is determined under federal preclusion law. The Bankruptcy Court held based on federal law that the Debtor did not have a full and fair opportunity to litigate, and thus, was not precluded from litigating the validity and amount of Best Western's claim.

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With regard to the \$116,076.27 in past due balances, the parties disagreed on whether the Debtor's liability for returned checks in the amount of \$49,068.05 (which was included in the \$116,076.27) should be determined under Arizona law, which permits recovery of twice the amount of the checks, or Connecticut law, which does not. Although the Agreement contained language stating that the Agreement shall be governed and construed according to Arizona law, the Agreement contained no provision concerning payment by or dishonor of a check. Therefore, the Bankruptcy Court performed a choice of law analysis and looked to the United States Supreme Court decision, *Van Dusen v. Barrack*, 376 U.S. 612 (1964), which directs that the choice of law rules of the state where the underlying prepetition complaint was filed controls. As Best Western's claim was wholly derived from the claim it filed prepetition in the District Court in Arizona, the Court found that the Arizona choice of law rules apply. Arizona courts' choice of law rules dictate that they apply the law of the state that has the 'most significant relationship' with the parties and the dispute. Since Best Western is an Arizona corporation, received the checks in Arizona, deposited them in an Arizona bank, and the Agreement contains a choice of law provision specifying that it be construed pursuant to Arizona law, the Bankruptcy Court held that Arizona had the more significant connection to the checks at issue and applied Arizona law to determine the Debtor's liability on the checks. As such, the Bankruptcy Court found that since \$49,068.05 was included in the \$116,076.27, Best Western's claim against the Debtor's estate is allowed in the additional amount of \$49,068.05 over and above the \$116,076.27 in unpaid balances.

Best Western sought liquidated damages from the Debtor in the total amount of \$1,106,527.50. Per the Agreement, this amount was calculated by the average daily rate (\$97.00) multiplied by 150 total hotel rooms for a \$2,182.50 daily charge, multiplied by 507 days of alleged unauthorized use of the Best Western symbols from August 21, 2009 through January 10, 2011. The Bankruptcy Court applied Arizona law to determine the enforceability of the liquidated damages provision. Based on the evidence and the Debtor's assertion that all Best Western symbols were removed by October 15, 2009, the Bankruptcy Court allowed Best Western's claim for liquidated damages for the 56 day period from August 21, 2009 through October 15, 2009 for a total amount of \$122,220.00.

Despite Best Western's claim that the Debtor improperly used Best Western's symbols on the internet and by signage after October 15, 2009, the Bankruptcy Court disallowed any and all liquidated damages claimed on these grounds. As to the internet, the Bankruptcy Court held that there was no evidence to support Best Western's claim for \$984,307.50 in damages that the Debtor used its symbols on the internet. As to signage, the Bankruptcy Court found that damages totaling \$235,710 stemming from the curved shape of the Best Western sign that had otherwise been covered was disproportionate rendering the provision an unenforceable penalty clause. Because the Bankruptcy Court found the liquidated damages provision to be unenforceable as to the events after October 15, 2009, it limited Best Western's recovery to its actual damages which Best Western was unable to show. Thus, Best Western's entire claim for damages after October 15, 2009 was disallowed.

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As a result of this decision, Best Western's claim was reduced from \$1,320,739.87 to \$287,364.29. Since creditors with the largest claims control the votes in the confirmation process, this drastic reduction will not only impact Best Western's voting power, it will significantly reduce the distributions to Best Western on its claim, while, at the same time increase pro rata what other creditors receive on their claims.

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