

The image features a wooden gavel resting on a wooden surface, with a blurred Texas state flag in the background. The text is overlaid on the image in a white serif font.

Texas Supreme Court Update *Opinions Issued February 7, 2020*

By Stephen Gibson

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***Enforceability of Liquidated Damages Clauses:* An otherwise enforceable liquidated damages clause can be an unenforceable penalty if the breaching party proves an “unbridgeable discrepancy” between the prospectively agreed liquidated damages and actual damages when the breach occurs.**

Freedom of contract does not allow for liquidated damages that are more than “just compensation.”

The court frequently espouses freedom of contract as an especial Texas value. However, according to the unanimous opinion of Justice Bland in [Atrium Medical Center, LP v. Houston Red C, LLC](#), this freedom does not include a right to agree to a liquidated damages provision for more than “just compensation for the loss or damage actually sustained.” Even though a particular clause may not have been intended to have a punitive effect, it is unenforceable nonetheless if it effectively creates an “unbridgeable discrepancy” between liquidated and actual damages.

Courts enforce liquidated damages provisions only if the party seeking its enforcement proves (1) the harm from the breach is difficult or impossible to estimate accurately and (2) the liquidated damages amount reasonably estimates just compensation from the information available when the agreement is made. “Just compensation” is determined by comparing agreed-upon liquidated damages with actual damages from the breach. If the actual damages are “much less,” then the liquidated damages clause is not enforceable.

“Just compensation” is relative to the actual damages that the liquidated damages clause was intended to replace because actual damages were too difficult to calculate.

The “just compensation” standard is subjective and defeats the *raison d’etre* for liquidated damages provisions. If one must prove actual damages as a talisman for enforcing the liquidated damages provision, why allow liquidated damage provisions at all? After all, the purpose of such provisions is to alleviate the difficulty of proving actual damages and relies on the parties to negotiate an amount acceptable to both when that number is too prospectively uncertain. Fettering the parties’ negotiating powers with a retrospective “just compensation” standard only makes sense when the parties’ bargaining power is unequal, as in a contract of adhesion.

Despite the clear suggestion to the contrary in early portions of the opinion, *Atrium Medical* ultimately announces “[a] breaching party need not prove the other party’s actual damages to invalidate penalty provisions ... [if they are] ... facially invalid.” The opinion unhelpfully articulates no objective standard for when a penalty is facially invalid. It only declares a penalty nearly six times the amount of actual damages was not a reasonable prediction of just compensation.

“Just compensation” should be measured relative to expectation, reliance or restitution damages.

Some sanding of the edges is also necessary to square *Atrium Medical*’s own “just compensation” test. The opinion points out evidence that anticipated demand for the contracted services actually varied widely and were difficult to predict. Depending on the language of the penalty provision, “just” compensation is measured with reference to one or more of the three kinds of breach-of-contract damages: (1) expected profits, (2) reliance costs – i.e., out-of-pocket

costs incurred in attempting to perform and (3) restitution – i.e., the amount necessary to restore the benefit the complying party conferred on the breaching party.

Long-term industry statistical data will satisfy the proponent's burden to show the liquidated damages were a reasonable damages forecast.

Here, the party seeking to enforce the liquidated damages provision relied on the expected profits damages model. It adduced evidence of a nearly 40% industry profit margin from data spanning 40 years. The opponent relied on profit margins from differing industries, which credited with no probative value for deciding whether liquidated damages were “just” compensation. The opinion concluded, therefore, that the proponent of liquidated damages met its burden of showing difficulty of estimating actual damages and that the liquidated damage amount was a “reasonable forecast” of just compensation. The opinion leaves unanswered whether the data used to establish what is “just compensation” must be of the type and quality an expert would rely on.

The burden shifts to the opposing party to show an unbridgeable discrepancy between the liquidated damages and actual damages.

Apparently, when the proponent adduces some evidence the liquidated damages are “just,” the burden shifts to the opponent to show the liquidated amount was unreasonable relative to what the actual damages would have been. Meeting this burden requires proof of an “unbridgeable discrepancy” which in turn requires establishing the *type* of damages measured by the liquidated damages provision – expectancy, reliance or restitution – and some evidence of the *amount* of those damages. Such amounts may take into account reductions for mitigation. However, the liquidated damages opponent in this case failed to adduce any evidence that mitigation would have reduced the amount of actual damages. Because the proponent met its burden, the trial court could not refuse to enforce the liquidated damages clause due to an “unbridgeable discrepancy” that rendered unenforceable.

Is “unbridgeable discrepancy” a question of fact or a question of law?

Atrium Medical addresses the evidentiary standard in terms of whether the compensation is “just.” This suggests that the question is one of law. On the other hand, the opinion speaks in terms of whether the compensation is “reasonable,” which suggests a role for the trier of fact. The final paragraph of the opinion declares that it was affirming the judgment of the appellate court because “the breaching party failed to demonstrate an ‘unbridgeable discrepancy.’” Given that the supreme court has no ability to make factual sufficiency determinations, this declaration appears to be one that is based on the no-evidence test – which presents a question of law. As such, it is unclear to this writer whether, when the evidence conflicts whether the penalty is reasonable, a question for the jury exists. The cautious practitioner will request a question and appropriate instructions until this issue is resolved.

Appellate Procedure: If a ground for appeal – i.e., the propriety of a challenged ruling – is presented, the court of appeals has authority to order supplemental briefing on all subsidiary issues even if not explicitly argued in the opening briefs.

Half a century ago, the supreme court famously ruled in *Malooly Bros. v. Napier* that a summary judgment could be supported on any ground asserted by the movant. A failure to challenge all such grounds on appeal meant the appellate court could summarily affirm the summary judgment on the unchallenged grounds. Since then, the Texas Supreme Court has adopted a policy preferring decisions based on the merits to disposing of cases on procedural defects and oversights.

In *St. John Missionary Baptist Church v. Flakes*, the issue was whether an appellate court still had the discretion to permit supplemental briefing to allow the appellant to challenge all grounds of a dismissal order that did not specify whether it was based on lack of standing or ecclesiastical abstention. The appellant only briefed standing and the court of appeals affirmed on the unchallenged alternative basis for dismissal: ecclesiastical abstention. The majority of the intermediate appellate court reasoned it was beyond its power to request additional briefing on an issue the parties did not initially brief.

In a *per curiam* opinion, the court rejected the notion the parties had not “raised” the ecclesiastical abstention issue. Under Texas Rule of Appellate Procedure 38.9, appellate courts are permitted to ask the parties to rebrief a case not “properly presented.” In general conformity with its preference for deciding cases on the merits rather than procedure, the court’s rules further provide that an issue statement raises “every subsidiary question ... fairly included.” Tex. R. App. P. 38.1 (f). An oft-stated corollary is a party can raise any and different arguments to support a ground of error, even if not urged previously.

While this is a helpful sentiment, it leaves to the eye of the beholder what is a ground for error and what is simply a supporting argument. Stated simply, as long as the party challenges the ruling as erroneous, it can argue that it was erroneous for new and different reasons than originally urged. The court distinguished the *Malooly* rule from the situation before it because the unchallenged ground for affirming the summary judgment was limitations – a stand-alone basis for upholding the judgment that was entirely independent from the legal reasoning attacked on appeal. In *Missionary Baptist*, however, the ecclesiastical abstention doctrine was inseparable from and overlapped the larger challenge to standing.

[T]he parties disputed whether the church’s bylaws governed church membership and whether those bylaws were ecclesiastical or secular.... The [opponents of dismissal] expressly argued that questions surrounding the plaintiffs’ memberships, and therefore ... standing, were ecclesiastical: “When you talk about who is a member [and who’s] not ... what’s secular about that? That’s religious.”

Similar arguments were made concerning the court’s jurisdiction to decide whether a pastor had been removed by the church membership or could still exercise authority as the leader of the congregation was likewise a sectarian rather than secular matter.

According to the *per curiam* opinion, the ecclesiastical abstention question was subsidiary to and included within the larger issue over standing. Because the overarching standing issue had been presented in the briefs, the appellate court had the authority under appellate rule 38.9 to request additional briefing. The *per curiam* opinion makes clear, however, that saying the court had the *authority* to request additional briefing did not mean it was *obligated* to do so. However, given the oft-stated preference for deciding cases on matters of substance instead of procedure, one would think that lack of evenhandedness would be an issue if the appellate court arbitrarily denied such an opportunity to affirm a judgment.

Although this case is explicitly one about appellate procedure, trial advocates should keep it handy as a reminder to cast issues in motions broadly so that there’s room to maneuver if a particular, more narrow, supporting argument fails and a different argument needs to be first asserted later.

Texas Tort Claims Act: Authorization alone is not a “use” of personal property for which immunity is waived unless that authorization is given for a particular purpose or situation.

The riot exception in the Tort Claims Act applies when the injury-causing event is in response to two groups of inmates who are ignoring stand-down orders and making violent threats and gestures.

In response to a disturbance between two groups of inmates, a prison officer was issued a tear gas gun, an indoor tear gas shell and an outdoor tear gas shell. The label on the outdoor shell had been “smeared off” so the officer was not aware it presented a fire hazard and was only for outdoor use. After inmates repeatedly refused to comply with orders to stand down, the officer received authorization to use the tear gas gun. A group of inmates refused to comply with repeated orders and the officer unwittingly loaded the outdoor-only tear gas shell. One of the inmates was burned and suffered a fracture as a result.

[*Texas Dept. of Criminal Justice v. Rangel*](#) resulted from that inmate’s suit alleging the TDCJ breached its duties “by dispensing the outdoor shell for indoor use, by keeping the shell without its label intact, and by approving the use of force.” The inmate alleged the Tort Claims Act waived TDCJ’s immunity because his injuries resulted from “use” of tangible personal property for which the act waived governmental immunity. TDCJ relied on cases holding that merely authorizing the use of property, standing alone, was not a “use” for purposes of the statutory waiver.

The court deemed this general rule inapplicable because the circumstances involved more than an open-ended or abstract authorization. Here, the authorization and issuance of the tear gas gun and shells were to address a specific situation and for a specific purpose. This was enough to make the authorization a “use” of tangible personal property to which the waiver of immunity applied. The TCA does not require physical manipulation of the tangible personal property for a “use” to occur.

The opinion then turns to whether the “riot” exception applied so that this use of tangible property was removed from the scope of the TCA’s waiver. The plaintiff maintained that the disturbance was not a “riot” for purposes of the waiver. The TCA did not define “riot” so the court resorted to various dictionary definitions of a “riot” as a “tumultuous disturbance of the public peace” by more than two persons acting with common intent. The court rejected plaintiff’s contention that the Penal Code’s more specific and narrower definition of “riot” should apply. It reasoned that if the Legislature had intended to limit the exception to the criminal offense of “riot” in the Penal Code, it could have said so. It didn’t. Nevertheless, the opinion said the Penal Code definition provided “guidance” about what a “riot” is because it is something that officials could reasonably rely on. The Penal Code definition made clear that “riot” included the threat of personal injury or property damage. The opinion concluded that the situation confronted by the prison guards involved such a risk.

The plaintiff maintained, however, the situation could not be considered a “riot” because it evolved so slowly that the guards had the opportunity to consult with others and plan how to address the situation. The court rebuffed this suggestion. The protracted nature of the event did not neutralize the risk of personal injury or property damage presented by two inmate groups’ repeated defiance of orders to return to their bunks and their ongoing verbal threats and “violent gestures” directed at one another.

The opinion concluded that the evidence presented in the trial court established as a matter of law that the situation was a “riot” for purposes of the exception to the waiver of immunity contained in the TCA. Accordingly, it ruled that TDCJ’s immunity had not been waived and dismissed the plaintiff’s suit for want of jurisdiction.