

through securitization.

In sum, the implications of the composite view of aircraft financing in 2001 are not fully clear: the strong demand for air travel, high fuel prices, increased aircraft supply, lower fleet valuations and reduced lease rates can be said to resemble a puzzle with too many pieces. One thing is certain—with both aircraft valuations and lease rates down, the industry is in a holding pattern for middle-market lessors, who await a shift in wind direction to see how profitability will trend. Though the current yield curve is inverted and interest rates may trend lower in the future, any uptick in rates will cause the level of challenge faced by lessors to rise correspondingly.

### Maximizing Opportunities

Regardless of interest rate levels, however, the reality is that borrowers will need financing—in any market. As the aircraft financing market becomes better defined in the months ahead, borrowers will look to innovative, responsive lenders who have strong processes in place to move deals forward and have the ability to structure transactions to meet the demands of any business environment.

For their part, borrowers will need to display a similar market savvy, fully comprehending each deal they bring to a lender and demonstrating a capacity for performing to the lender's expectations. In today's challenging market, this means that borrowers will have to either increase equity contributions or be willing to furnish more upside to lenders. Regardless of market conditions, however, it's essential

that borrowers and lenders establish partnering relationships that will benefit both in the future.

Middle-market lessors who have experienced the full gamut of highs and lows in aircraft financing—from the low-aircraft-valuation era of the early 1990s to the healthy valuations and decreased loan costs of the mid-1990s to the current holding pattern—know that the market's only constant is its constantly shifting nature. Accordingly, competitive strategies for the year ahead will largely be dependent on the size and business focus of a given participant.

While the biggest players have the advantage of leveraging their relationships with manufacturers, players occupying other niches on the industry spectrum will adopt a variety of approaches to the market, from holding their portfolios to acquiring more assets. Invariably, the pattern that currently holds sway in

aircraft financing will give way to a more favorable trend—lower interest rates and higher lease rates and asset valuations.

### Borrower-Lender Bond

Until debt becomes more available and the market assumes an upward trend, 2001 will call for middle-market companies to take judicious risks in order to realize reasonable returns—an end most likely to be attained when a carefully nurtured, longstanding borrower-lender relationship is the means. Borrowers and lenders who recognize each other's perspectives, appreciate their shared goals and understand the nuances of aircraft financing—such as its complex accounting and tax issues—will forge partnerships capable of withstanding the challenges and maximizing the opportunities within any business climate.



## LESSOR DEFAULTS

# Acceleration of Damage Clauses: Critical Choices in Lease Enforcement

By Anthony L. Lamm

Although most lease contracts contain some provision for the acceleration of rental payments in the event of a lessee's default, the question has often been raised as to the validity of these clauses. Are they actually enforceable and, if so, when? The answer revolves around the way in which the lessor chooses to proceed in the event of a default.

When a lessee defaults on a lease obligation, one of the critical decisions for a lessor is whether to repossess the equipment covered by the lease. This is critical because of the impact it will have on the damages a lessor can recover in terms of their ability to accelerate the balance of rental payments due

under the remaining term of the lease measured from the date of the actual default.

If the lessor repossesses the equipment, then the lessor will be entitled to sue for the remaining balance of the lease payments due under the lease and recover the sum of those payments (discounted to present value) if the lessor holds the equipment for the lessee for the remaining term of the lease agreement. See Article 2A 529(b). If the lessee retains possession of the equipment, an action for the full, unpaid rent (discounted to present value) is available as to goods not lost or damaged. 2A 529(a)(1)(ii). Under 2A 529(a)(2)(ii), the same result is also true if the lessee returns possession of the goods to the lessor and the lessor is or apparently will be unable to dispose of them at a reasonable price after a reasonable effort.

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## Damage Clauses

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The reason the statute contains the requirement that the lessor repossess and hold the equipment or be unable to repossess the equipment from the lessee before the lessor has the right to recover from the lessee the full rent for the remaining term of the lease (discounted to present value) is because of the expectation that the lessor will realize its residual interest in the equipment at the end of the lease term by sale or re-lease. See Uniform Commercial Code Comment, 2A-529.

### Mitigation of Damages

The law recognizes a nonbreaching party's duty or obligation to mitigate damages that is co-existent with the right to accelerate the rental due for the remaining months of the term of a lease agreement. See *Fairfield Lease Corp. v. 717 Pharmacy Inc.*, N.Y. City Civ. Ct., 441 N.Y. S.2d 621 (1981).

The general rule on mitigation of damages is that a party has "the active duty of making reasonable exertions to render the injury as light as possible," *Hamilton v. McPherson*, 28 N.Y. 72, 76-77 (1863), and that "no recovery may be had for losses which the person injured might have prevented by reasonable efforts and expenditures," *Mayes Co. Inc. v. State of New York*, 18 N.Y. 2d 549, 554, 277 N.Y. S.2d 881(1966); Williston on Contracts, 3d Ed., Sec. 11: 174-181.

### Attempt to Collect Liquidated Damages

Acceleration clauses are valid in cases where the only obligation is the payment of money, such as a loan transaction. See *Matter of Merwin v. Willoughby Co.*, 206 Fed. 116 (N.D.N.Y. 1913); *Fairfield Lease Corp. v. Marsi Dress Corp.*, 60 Misc. 2d 363, 303 N.Y. S.2n 179 (Civ. Ct., N.Y. Co., 1969). On the other hand, if the lessor has not made reasonable efforts to minimize its loss, courts have denied summary judgment in actions brought by lessors to recover accelerated rental payments because

of a lessee's breach. *A.M.F. Inc. v. Cattalani*, 430 N.Y. S.2d 731, 77 A.2d 779 (4th Dept. 1980); *Chemical Bank v. Queen Wire and Nail Inc.*, 75 A.D. 2d 999, 429 N.Y. S. 2nd 100 (4th Dept. 1980).

Upon a breach in payment by the lessee, lessors need to know that accelerating the balance of the payments remaining to be paid over the term of the lease agreement is viewed by the courts as an attempt to recover liquidated damages. This identification is important, since courts will only enforce liquidated damages clauses as recoverable damages if they represent a sum that reflects an agreement by the parties, which was arrived at by a good-faith effort to estimate in advance the actual damages that will probably ensue from the breach.

On the other hand, if the liquidated damages clause merely represents a "penalty" because the clause is not a pre-estimate of probable damages and is in the form of a punishment designed to prevent breach, the clause will not be enforced. *Commonwealth Dept. of Environmental Resources v. Hartford Acc. and Indem. Co.*, 40 Pa. Cmwth. 133, 396 A.2d 885 (Pa. Cmwth. 1979). A penalty provision will be held unenforceable even if parties of equal bargaining power, negotiating at arms length, agree to the penalty provision in good faith. Restatement of Contracts 2d, § 356 comment: *Robbins Motor Transport Inc. v. Associated Rigging & Hauling Corp.*, 944 F. Supp. 409 (E.D. PA 1996).

Therefore, the measure of the damages in the formula, called an "acceleration clause," defines whether a court will enforce the attempted recovery of the agreed-upon damages. *Electrical Products Consolidated v. Sweet*, 83 F.2d 6 (C.A. 10th, 1936), held that the lessor of preconstructed and maintained neon advertising signs was entitled to repossess signs and declare the balance of rentals due, but to recover only actual damages for the breach thereof after repossession of the signs.

In defining actual damages, the circuit judge maintained the long-

settled view in assessment of damages for breach of contract that the injured party is entitled to the benefit of his bargain; citing § 329 of The Restatement of Contracts which states: "Where a right of action for breach exists, compensatory damages will be given for the net amount of the losses caused and gains prevented by the defendant's breach, in excess of savings made possible."

The comment to that section, however, goes farther in discussing the measure of damages for a breach of full performance of a contract and states that the value of the completed, full performance of the contract (e.g., the accelerated rental payments due under the term of a lease agreement) is one of "the chief elements in fixing the amount that may be recovered as damages. The difference between this value and the cost of the plaintiff's own performance, if the latter is the lesser sum, is a profit to which the plaintiff practically always has a right as a part of the damages." Specifically, the court in *Sweet* held that "the measure of damages is the cash value of those agreements (leases) less whatever savings accrues to lessor from the breach." (explanation supplied) *Id.* at 5. "To arrive at the actual damages in these cases, the unpaid balances should be used as a basis." *Id.* at 6.

The Uniform Commercial Code's Comment to 2A 504 "Liquidated Damages" states that "A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or release) of the leased goods is the lessor's damages....Whether these formulas are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to."

Through the analysis of the common law interpreting acceleration clauses as liquidation damage provisions, the Article 2A formula does