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# A Valentine's Day Massacre of Liquidated Damages: *In re Republic Airways Holdings Inc.*

By Arlene N. Gelman and Edward K. Gross

A bankruptcy court ruling in New York this year could be problematic for lessors when enforcing certain typical acceleration and collection remedies against defaulting customers. Specifically, *In re Republic Airways Holdings Inc.* may impair the reliability of SLV-based liquidated damages provisions even in hell-or-high-water leases and guaranties of those obligations under unconditional and absolute guaranties. The authors will explain why they believe that the court erred, and discuss the enforcement and transactional implications to lessors.

Enforceable liquidated damages remedies are among the most essential provisions in many of the lease forms used by industry participants when documenting equipment financings and refinancings. On Valentine's Day 2019, the United States Bankruptcy Court for the Southern District New York issued an opinion in which it refused to enforce both an agreement by a lessee in a hell-or-high-water lease to pay liquidated damages to the lessor, as well as a guarantor's absolute and unconditional guarantee of that obligation.[1]

It is important that equipment lessors understand the implications of this bankruptcy court holding because it is likely to be considered by other courts when deciding the enforceability of similar liquidated damages remedies or raised by lessees after default or when negotiating lease documents that include these provisions. Should other courts follow this case, it could affect the credit underwriting, pricing, asset management, documentation, and other functions associated with deal origination, as well as having legal implications to transactional, enforcement, and bankruptcy lawyers who frequently represent equipment finance providers.

The court's opinion related to a motion for summary judgment (SJM) with respect to objections by Republic Airways Holdings Inc., et al. (Republic or the debtors) to claims filed by Wells Fargo Bank Northwest, N.A., as owner trustee, and ALF VI Inc. as owner participant (Residco), in connection with Republic's Chapter 11 bankruptcy case. Residco's claims included liquidated damages and other amounts resulting from Republic's rejection of seven commercial aircraft leases.[2]

Republic's SJM raised two major issues for the court to consider:

> (i) whether the liquidated damages provisions in the leases violate Article 2A of the New York Uniform Commercial Code and are therefore unenforceable as against public policy, and (ii) if so, whether the guarantor of the obligations in the leases is nevertheless liable to pay the otherwise unenforceable liquidated damages.[3]

By its opinion, the court granted Republic's SJM, finding that the liquidated damages provisions in the rejected leases were unenforceable against both the Republic lessee and guarantor because the court believed that these provisions violated the UCC Sec. 2A-504 requirement that a liquidated damages formula must be "reasonable in light of the then-anticipated harm from default."[4]

The authors of this article believe that the court's findings were based on misinterpretations or mischaracterizations of the applicable statutory and case law, as discussed below. Although the Bankruptcy Court's opinion is nonbinding on future litigants, there are concerns that this issue will reappear in other litigation or during negotiations and undermine lessors' reliance on standard and essential enforcement remedies. Accordingly, it is important that arguments similar to those made by Republic continue to be challenged by lessor parties seeking to enforce their liquidated damages provisions.

We will discuss the *Republic* case below, explain the relevant commercial laws and why

we believe that this court erred in its legal analysis, and suggest strategies that might ameliorate the implications of this case.

The liquidated damages formula is carefully calculated, scrutinized, and ultimately agreed upon, as documented in the lease by the parties. By entering into the lease, both the lessee and the lessor are documenting their mutual agreement to be bound by and have the benefit of these terms.

## CERTAINTY OF PAYMENT IS ESSENTIAL TO A LESSOR'S WILLINGNESS TO INVEST

Ask most credit officers in the equipment finance industry and they will agree that the exit strategy contemplated in any credit-approved equipment finance transaction must include a remedy entitling the lessor to demand payment by the lessee of an amount calculated so that the lessor recovers its investment plus anticipated yield in the event of a default during the lease term.

Accordingly, most lease forms include some version of a liquidated damages remedy by which the lessor may, upon a default, demand and recover from the lessee an amount that will allow the lessor to achieve the benefit of its bargain, as contemplated at lease commencement. Lessors and lessees agree to liquidated damages to avoid any uncertainty that a court might award a lessor an amount that is unexpectedly lower or higher than the parties contemplated when they entered into the lease.

As is the case with all of the other economic terms in leases entered into for the purpose of providing acquisition financing or refinancing of a lessee's capital equipment, the liquidated damages formula is carefully calculated, scrutinized, and ultimately agreed upon, as documented in the lease by the parties. By entering into the lease, both the lessee and the lessor are documenting their mutual agreement to be bound by and have the benefit of these terms.

Further, the certainty that this agreed amount will be paid, as calculated, is often supported by other provisions in the lease documents, including, among others, the lessee's promise to pay all amounts due under the lease without defense or other abatement (i.e., hell or high water), and the lessee's representation that the lease is enforceable in accordance with its terms.

With respect to lease transactions supported by a guaranty, the guarantor is required to confirm that the guarantor will unconditionally guaranty the payment of all amounts payable under the lease, irrespective of any defense or claim, including any claim that the lease documents were unenforceable.

Lessors rely on the enforceability of these promises when deciding whether they will provide financing requested by the customer. Applicable law, including the UCC, interpretive cases, and other commercial laws, recognizes that sophisticated parties to commercial transactions, especially if represented by counsel, understand the implications of their promises regarding, among other things, liquidated damages and unconditional guaranties, and further understand that the UCC should not impede their freedom to bind themselves by contract to make those promises and guaranties.

If these expectations are undermined by courts choosing to ignore applicable statutory and case law and scholarly commentary, the result could include an erosion of the available lease financing or refinancing being offered to large and small businesses.

## THE LAW SUPPORTS ENFORCEMENT OF LIQUIDATED DAMAGES REMEDIES IN LEASES

### UCC Sec. 2A-503 (et al.): Freedom of Contract

Prior to the adoption of UCC 2A,[5] parties to lease transactions, and courts asked to resolve disputes between such parties, relied on general contract law and lease-related cases with respect to the pertinent lease terms.[6] Article 2A was a departure from both the case law and the analogous provisions of the other UCC articles that were templates for many UCC 2A provisions.

Although UCC 2A is applicable only to transactions constituting "true" leases,[7] the drafters of UCC 2A looked to provisions of UCC 2 (sales) and UCC 9 (secured transactions) for guidance regarding what they believed to be appropriately correlative matters. Many UCC 2A provisions relating to commercial (not consumer) leases are lessor favorable,[8] particularly the statutory rights afforded a lessor under a lease constituting a UCC-2A "finance lease" pursuant to UCC Sec. 2A-103(1)(g).

The lessor-favorable provisions of UCC 2A afford lessors in true lease equipment financings and refinancings the expectation that, as to most matters occurring prior to lease expiration and return of the related equipment, lessors will recover their investments, without defense or abatement.[9]

The provisions of UCC 2A also generally permit the parties to agree to lease terms that modify, supplement, or are otherwise inconsistent with the correlative

provisions of UCC 2A, subject to certain conditions.[10] The Article 2A drafters noted in the relevant official comments their intent to codify leasing parties' freedom of contract.[11] This freedom of contract allows the parties to bargain for the various rights, remedies, risks, and burdens, without concern that a court might interfere with the commercial judgment of the parties as reflected in the terms and conditions of a lease.[12]

The freedom of contract afforded to both lessors and lessees promotes lease financing of capital equipment pursuant to terms bargained for by the parties. These bargained-for terms often reflect the circumstances in which the parties find themselves, including among others, the then-market conditions, credit and asset-specific considerations, and other matters pertinent to their respective decisions to enter into the subject lease transaction.

The drafters of Article 2A clearly appreciated the role of effective default and remedy provisions in equipment lease transactions, respecting the judgment of the parties to craft provisions that aligned with the business realities of these transactions. For example, although UCC Sec. 2A-523(1) lists certain statutory events of default, UCC 2A defers to the parties to rely instead on negotiated default triggers to be included in their lease documents.[13]

By doing so, Article 2A left it to the parties to determine with appropriate specificity what events might, with or without notice or cure periods, constitute defaults and give rise to statutory or negotiated remedies. This deference by the Article 2A drafters allowed leasing parties to cover not only the typical payment or other defaults or breaches, but also defaults relating to customer-related credit or corporate matters, equipment-specific matters, or other events or circumstances contemplated in the internal credit approval underlying the lessor's willingness to enter into the transaction.

Among the most important remedies to a lessor after the occurrence of a material payment or performance default are the rights to cancel the lease,[14] recover possession of the leased equipment,[15] and demand that the lessee pay damages in an amount that will, collectively, allow the lessor to achieve the benefit of its bargain as contemplated when it entered into the lease.[16]

Although UCC 2A provides a lessor with various fact-based damages remedies that may be exercised upon a lessee's default,[17] most lease documents include damages remedies that are consistent with the economics and market practices relating to the contemplated lease transaction, and such additional or substituted remedies are also allowable under Article 2A.[18] Pursuant to UCC Sec. 2A-503(1), leasing parties may agree to include in their lease documents similar or different default remedies from those provided by statute in UCC 2A.[19]

Of course, the enforceability of negotiated, nonstatutory remedies is still subject to the prohibition in UCC Sec. 2A-108 against unconscionable terms.[20] But, as noted by White and Summers, "the drafters continued to respect leasing parties' freedom of contract by allowing courts to sever any unconscionable term (as opposed to voiding the lease or even a single lease provision in its entirety)."[21]

Similarly, UCC Sec. 2A-504(2) allows a lessor to exercise the other remedies available under UCC 2A if the liquidated damages provision does not comply with UCC 2-A-504(1), or if it is "an exclusive or limited remedy that circumstances cause to fail of its essential purpose."[22]

## UCC Sec. 2A-504: Liquidated Damages

Among the provisions both relied upon by lessors for certainty of payment and supporting the parties' freedom of contract flexibility is UCC 2A-504. As was the case with Article 2 in the context of contracts for the sale of equipment, inventory, and other "goods,"[23] Article 2A drafters chose to expressly support the validity of liquidated damage remedies in leases by including UCC 2A-504(1).

This statutory recognition of liquidated damages in leases was similar to, but meaningfully different from, the correlative UCC 2 coverage of liquidated damages, and reads as follows (emphasis added):

> *Damages* payable by either party *for default,* or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, *may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.*[24]

The differences between the drafters' approach to UCC 2 and UCC 2A liquidated damages remedies are obvious when comparing the text of UCC 2-718 and UCC 2A-504. As noted above, the drafters of UCC 2A-504 chose a more transactional approach regard-

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ing liquidated damages than was the case with the much more restrictive statutory liquidated damages provisions of UCC 2-718,[25] including the requirements in UCC 2-718 regarding the "difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy."[26]

As explained by the drafters, "[m]any leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission" and UCC 2A-504(1) "has created a revised rule that allows greater flexibility with respect to leases of goods."[27]

The Article 2A drafters further explained the decision to exclude the more restrictive Article 2 tests as follows: "The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind retaining these two additional requirements here was thought to be outweighed."[28]

As drafted, UCC 2A-504 purposefully excludes the more restrictive tests in UCC 2-718 and in (non-UCC 2A) common law,[29] instead allowing leasing parties to use their *reasonable* commercial judgment when determining at lease commencement the damages recoverable by the lessor if the lessee fails to pay or perform as promised, or the lessor suffers the existence of some other default, under the lease.[30]

Consistent with the notion that the parties should have the freedom to bargain for a reasonable liquidated damages formula or other calculation methodology for their transaction, the provisions of UCC 2A-504 do not specify what may or may not be a valid liquidated damages formula or other calculation methodology applicable to all or any specific types of lease transactions.

However, the official comments to UCC 2A-504 do provide examples of common liquidated damages formulas, without endorsing or criticizing any of them.[31] Per Official Comment 3:

> 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 re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages.
>
> Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common.
>
> Whether these formulae 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.[32]

Of particular relevance to the *Republic* case is the recognition in the official comments that it is common leasing practice for the parties to rely on liquidated damages that include a residual value component.[33]

## Stipulated Loss Value-based Liquidated Damages Provisions

As noted in the above-referenced official comments, UCC 2A-504 does not endorse a particular formulation for what might constitute a liquidated damages amount or formula that is "reasonable in light of the then anticipated harm caused by the default or other act or omission."[34]

Most leases include default-triggered damages remedies by which the lessor may demand payment from the lessee of damage amounts. These amounts often include some or all of: all accrued and unpaid rent and other amounts payable on or prior to the date of the lessor's demand, together with tax and other indemnification payments, amounts attributable to specific breaches, and enforcement-related costs.

However, the component in lease damages remedies that is most often litigated relates to stipulated amounts or formulas that are intended to approximate at the point of determination the amounts the lessor expected to receive had the lease not been canceled or terminated prior to its scheduled expiration.

There are two primary types of these stipulated acceleration damages. One type would require a lessee to pay all unaccrued rent, discounted to present value by a reasonable discount rate, less (net) actual or market rent for the coterminous re-lease term, discounted by the same discount rate. The other type includes both the accelerated rent amount and a residual value component, reduced by the (net) sales proceeds or market sales value of the leased equipment.

This residual value component is often specified in the lease or in a schedule or other attachment to the lease, as a specific amount or as a percentage of the purchase price and other amounts paid or "financed" by the lessor in connection with its acquisition and leasing of

the equipment. The stipulated amount or percentage will in most cases correlate to a scheduled rent payment date and decline incrementally from commencement until the scheduled expiration of the lease.

A typical specified or formula-derived amount[35] will, as of each correlative rent payment date, approximate the aggregate of the remaining periodic rent payments and anticipated residual value (each discounted to present value at an agreed discount rate), any assumed but unrealized tax benefits, and, perhaps, a prepayment or other similar consequential damages charge.

However, in a "true" lease, the last scheduled amount or percentage corresponding with the lease expiry date should approximate the meaningful (i.e., neither fully amortizing nor nominal) residual value anticipated by the parties at lease commencement.

These specified or formula-derived amounts are often referenced as *stipulated loss value or casualty value* (SLV) amounts because they are also relied upon by the parties to determine the amount to be paid by the lessee or casualty insurer in the event that an item of equipment is destroyed, damaged beyond repair, or stolen, or the item suffers some other casualty. The parties may also rely on these amounts in connection with an early termination or purchase option relating to the leased equipment.

As discussed below, the liquidated damages formula in the *Republic* leases included an SLV-based component obligating the lessee to pay, among other amounts, the difference between the residual equipment value anticipated by the parties at lease commencement (discounted to present value), less the actual equipment value at the time of the disposition.

In *Republic,* the debtors argued that this formula component was inherently unenforceable as an unreasonable allocation to Republic of market value risk. The court agreed, even though the parties mutually accepted and relied upon the related SLV calculations and independent appraiser's estimation of the actual market value with respect to each aircraft during and after the terms of their leases.[36]

## Pertinent Liquidated Damages Cases

State law governs the enforceability of a liquidated damages provision in a lease, whether being considered in a bankruptcy or other federal court or in a state court.[37] In numerous cases, courts have been asked to consider, under the laws of a particular state, the enforceability of liquidated damages provisions in leases.

These cases cover a broad spectrum of transactional circumstances, including asset types, sophistication of the lessee, amounts claimed, bankruptcy or nonbankruptcy courts, and liquidated damage formula components.[38]

In *Republic,* the parties to the leases mutually agreed that New York law would govern the transactions, so the most relevant cases to be considered by the *Republic* court would be cases in which SLV-based liquidated damages provisions similar to those found in the *Republic* leases have been tested under the current New York law (i.e., UCC Sec. 2A-504).

## Case Law Addressing SLV-based Liquidated Damages Claims

Numerous courts have enforced liquidated damages provisions containing a residual interest component (whether applying pre- or post-Article 2A law).[39] Indeed, at least one court noted that the enforceability of such a common SLV liquidated damages formula was evidenced by "the fact that it is just such provision contemplated by the drafters of Section 2A-504."[40]

Courts have also refused to enforce SLV liquidated damages provisions after determining that these liquidated damages provisions failed UCC Sec. 504(1)'s reasonableness test. For instance, courts have refused to enforce SLV liquidated damages provisions that either did not decline at all or failed to decline at a rate the court deemed sufficient so as to satisfy the reasonableness test in UCC Sec. 504.[41] In addition, courts have rejected liquidated damages provisions that result in a windfall or double counting for the lessor.[42]

However, there are few notable cases that have stricken SLV liquidated damages provisions, even though such provisions did not contravene Article 2A standards. These cases, which have been cited by other courts (including the court in *Republic*) as persuasive or precedential authority,[43] should be carefully scrutinized. *Interface Grp.-Nevada v. TWA (In re TWA)*[44] and In re *Montgomery Ward Holding Corp.*[45] are two such cases.

Similar to the circumstances in *Republic,* in *TWA,* the value of the leased equipment unexpectedly and significantly declined between the time of lease formation and the breach triggering the leases' liquidated damages provisions.

Similar to the circumstances in *Republic,* in *TWA,* the value of the leased equipment unexpectedly and significantly declined between the time of lease formation and the breach triggering the leases' liquidated damages provisions.[46] Unlike *Republic,* the facts of *TWA* (all of which

occurred prior to 1994[47]) required the application of pre-Article 2A standards, including standards that the Article 2A drafters purposefully rejected.

The history of the related transactions was long and complicated by the time that the debtors filed Chapter 11 in 2016.

For example, Article 2A rejected the uncertainty and proportionality tests that clearly guided the *TWA* court's holding. Indeed, the *TWA* court's discussion of market risk shift is sandwiched between the Third Circuit complaining that the lessor (a) "never explained to this court, and certainly not to the satisfaction of the bankruptcy court, why actual damages could not be ascertained upon breach" and (b) "would have [the Court] disregard the requirement of proportionality because *TWA* expressly agreed to the formula as valid and enforceable." In that regard, the *TWA* decision has been statutorily overruled by Article 2A.

In addition, there are several reasons why *Montgomery Ward* also fails to support striking properly drafted SLV-based liquidated damages provisions. First, it appears that the "casualty value" component in the liquidated damages provision in that case declined yearly.[48] A reasonable estimate of the anticipated residual value for various types of equipment would take into account that the value of such equipment changes at a faster rate than on a yearly basis.

Second, and more importantly, the Third Circuit agreed that anticipated residual value of leased equipment is a measure of damages properly recoverable by a lessor and ultimately determined that the amount the lessor in *Montgomery Ward*

> was entitled to receive [was] the sum of (1) the amount of any unpaid rent, (2) the present value at the time of breach of the monthly rentals for the then-remaining 10 months of the leases, and (3) the then-present value of what would have been, when the lease terms began, the anticipated aggregate residual value of the leased equipment at the scheduled termination of the leases.[49]

As such, and despite contrary opinion commentary, the *Montgomery Ward* decision actually *supports* enforcing liquidated damages provisions including the above three components, as was the case with the *Republic* leases.

With all the above statutory and case law background in mind, we now turn to the specific facts and holding of the *Republic* case.

## THE REPUBLIC CASE

### The Pertinent Facts[50]

The history of the related transactions was long and complicated by the time that the debtors filed Chapter 11 in 2016. Some pertinent details regarding the transaction history are summarized below.

#### *The Original Leases*

The original leases related to sale-leaseback transactions entered into between June 2001 through November 2003, pursuant to which Wells Fargo Bank Northwest, N.A., as the owner trustee, and Mitsui & Co. (U.S.A.), Inc. (Mitsui), as original owner participant, purchased from Embraer-Empresa Brasileira de Aeronautica S.A. (Embraer) seven Embraer ERJ 145 aircraft and concurrently leased these aircraft to the Republic lessee (the Lessee) pursuant to seven lease transactions.

In sum, these were sale-leaseback transactions in which the Lessor funded the full purchase price for the aircraft and agreed to lease the aircraft back to the Lessee.

#### *Base Pricing Model*

The Lessee was a sophisticated party and represented by counsel experienced in aircraft transactions and sophisticated financial advisors. These financial advisors for the Lessee developed and negotiated the pertinent financial terms and provisions including the base pricing model (BPM) used to calculate the scheduled periodic rent (the basic rent) and the scheduled stipulated loss value amounts used for all seven original leases.

Based on the base pricing model, the calculation of the basic rent and stipulated loss value took into account the following:

(a) the amount to be financed by the Lessor,[51] including the sum of (i) the purchase price for each aircraft and (ii) the fees for the Lessee's financial advisor (the financed amount);

(b) the basic rent amounts will, if timely paid, cause the financed amount to amortize down to an agreed residual amount supported by an independent appraisal of the forward-looking estimated value of the aircraft at the end of the lease term; and

(c) interest accruing on the outstanding amount of the financing amount at the rate of 4% (on an after-tax basis).

At any point in time (e.g., on the date of a casualty or an event of default), the stipulated loss value specified in each of the original leases represented the related financed amount as amortizing down to the residual amount, together with an amount to compensate the Lessor for any failure to achieve its anticipated income tax benefits as a result of an early termination of that original lease. (Such amount is termed the *unpaid lease financing amount,* or ULFA.)

By agreement among all the parties, the base pricing model set forth a zero-sum equation in which the unpaid lease financ-

ing amount would be repaid to the Lessor in all circumstances upon a default by the Lessee. Accordingly, if the lease was terminated or canceled prior to the expiration of the lease term, the Lessor would be repaid the unpaid lease financing amount during the term from a combination of the basic rent payment prior to the early termination or cancellation date and the SLV calculated as of such early termination or cancellation date.

Also, if the lease was not earlier canceled or terminated, the Lessor expected to receive full repayment of the financed amount from a combination of the basic rent payment through the expiration of the lease term, and the net sales proceeds of the aircraft, which the parties all assumed would be no less than the residual amount.

*The Residual Value*

The residual value assumption by the parties was based on the expected future values published by AVITAS. When calculating the base pricing model for use in the determining the basic rent and SLV in each of the original leases, the parties relied upon the expected values for ERJ 145 aircraft for 20 years estimated by AVITAS in its bluebooks for aircraft market value, published at about the same time as the commencement of the leases.

The Lessor retained AVITAS to prepare a report that summarized the future-looking valuations determined by AVITAS at the start of the original leases for the expected values of the aircraft at the expiration of the leases. The parties took a conservative approach when determining the residual amount value for each of the aircraft, setting it at an amount that was expected to be materially less than the future-looking value expected to exist at the end of term for each of the leases based on the AVITAS valuations.

*Assumed Recovery of the ULFA*

The agreement among the parties that the economic terms of the original leases and other related transaction documents would allow the Lessor to recover the unpaid lease financing amount was consistently reflected in the pertinent provisions of these documents.

For example, the SLV of the aircraft at any given time prior to the expiration of the lease term was equal to the ULFA determined as of the applicable date. (That is, the original financed amount, less a credit for the basic rent payments made on or prior to that date, increased by a 4% after tax interest accrual on the unpaid balance, as adjusted by tax attributes.)

The SLV was used to determine the amount payable to the Lessor upon the occurrence of a casualty to the aircraft, the required casualty insurance coverage amount, the early purchase and termination options, and in the liquidated damages remedy. In the context of the liquidated damages remedy, not only was the SLV component calculated to achieve that purpose but so was the pre-lease expiry allocation of risk to the Lessee regarding a market value diminution of the aircraft, as later discussed.

*Manufacturer Support*

Embraer originally provided two forms of support to Mitsui as the original owner participant, including the deficiency agreements and the residual value guarantees. The deficiency agreements provided a limited protection for damages arising from events of default during the term of the associated lease, and the residual value guarantees provided a limited protection for damages arising due to a loss in value of the aircraft, assuming the associated lease was not canceled or terminated prior to its scheduled expiration date.

*The 2012 Amendments*

In connection with a restructuring of the original leases, the parties entered into various related agreements in 2012, including amendments to the original leases (the 2012 Amendments), a financial support agreement, a guarantee, and a reimbursement agreement. The 2012 Amendments amended certain provisions of the original leases, including adjustments to the scheduled periodic rent payments (the basic rent) and the return conditions, but no changes were made to the SLV tables or the liquidated damage amounts.

The restructuring included not only the 2012 Amendments but also:

(a) Mitsui agreed to rent concessions,

(b) Embraer agreed, pursuant to the reimbursement agreement, to pay certain amounts to Mitsui with respect to each aircraft, and

(c) the Lessee's parent corporation (Republic Airways Holdings Inc. or RAH) entered into a guarantee of the original leases as amended by the 2012 Amendments.

The 2012 Amendments amended certain provisions of the original leases, but no changes were made to the SLV tables or the liquidated damage amounts.

*The 2013 Amendments and Restatement*

The parties further amended the original leases (including the 2012 Amendments) by entering into amended and restated leases for each aircraft in 2013. Very few of the original lease terms were revised. Although the leases both eliminated the reimbursement structure implemented in connection with the 2012 Amendments and preserved the adjustments to the basic rent, the SLV, the

The Leases were "true" leases under UCC Sec. 1-203 and constituted "finance" leases within the meaning of Article 2A.

liquidated damages remedies, and the other economic terms of the original leases remained unchanged.

*The 2014 Assignment to Residco*

In 2014 Mitsui assigned its owner participant interest in the aircraft and the leases to Residco, which became the owner participant. In connection with the assignment, RAH issued the same form of guarantees to Residco and the owner trustee as were provided in 2012 for the benefit of Mitsui and the owner trustee, and the Lessee executed lessee consent letters (one for each aircraft) for the benefit of the lessor parties.

Under the Lessee consents, the lessee specifically confirmed to the lessor parties that, among other things, each of the leases "shall continue in full force and effect as the legal, valid and binding obligations of the … Lessee enforceable in accordance with its terms."

## The *Republic* Leases as Amended (the Leases)

The Leases were "true" leases under UCC Sec. 1-203 and constituted "finance" leases within the meaning of Article 2A. Among other pertinent terms, the Leases included:

(a) hell-or-high-water promises by the Lessee to pay any amount of "rent" (which includes both basic rent and SLV) when due and without defense or offset,

(b) Lessee representations and warranties that the original leases and other operative documents were "enforceable in accordance with their respective terms" such that the remedies would be adequate for the "substantial realization of the benefits" provided under such operative documents, and

(c) stipulations that the Leases were to be governed by New York law.

Each of the Leases included identical liquidated damages remedies by which the Lessor could demand that the Lessee pay, in addition to any unpaid basic rent for the aircraft, liquidated damages "for loss of bargain and not as a penalty (in lieu of basic rent payable for the period commencing after the date specified for payment in such notice)."

The liquidated damage formulas in the Leases included damages remedies entitling the Lessor to demand: (A) the sum of (1) unpaid basic rent due prior to the exercise of remedies, plus (2) the stipulated loss value (calculated as of such date), minus (3) the then "fair market sales value" (as defined in the leases), together with (B) all out-of-pocket enforcement costs and costs associated with exercising control over and disposing the aircraft.

The SLVs for each aircraft, correlating to each month of the Lease term, were set out in schedules to each of the Leases. The scheduled SLV amount for the first month is equal to the purchase price plus related transaction expenses for each aircraft.

As noted by the court, over the term of each Lease, "the SLVs adjust on a month-to-month basis such that, after accounting for monthly payments of basic rent and tax benefits, they are always equal to the amount that provides the lessor with a four percent return on the Aircraft purchase."[52] Upon expiration of the term, "the SLV equals the residual value that Lessor needs to realize from the Aircraft for its four percent return."[53]

*The Guaranties*

As previously noted, RAH entered into the guarantees in favor of the Lessor, pursuant to which RAH unconditionally and absolutely guaranteed the Lessee's obligations under each of the Leases. Each of the guarantees included all of the usual waivers of defenses, acknowledgments, and other provisions supporting the unassailable nature of RAH's guarantees of payment and performance under all circumstances. Among RAH's waivers and acknowledgments provided in each guaranty was the following:

> Guarantor understands and agrees that its obligations hereunder shall be continuing, absolute and unconditional without regard to, and Guarantor hereby waives any defense to, or right to seek a discharge of, its obligations hereunder with respect to the validity, legality, regularity or enforceability of any Operative Agreement, any of the Obligations or any collateral security therefor or guarantee with respect thereto at any time or from time to time held by any Guaranteed Party or any other circumstances whatsoever (with or without notice to or knowledge of [Lessee] or Guarantor) that constitutes, or might be construed to constitute, an equitable or legal discharge of [Lessee] or the Obligations or of Guarantor under this Guarantee (other than payment and performance of the Obligations in full).[54]

*The Bankruptcy, Claims, and Objections*

The debtors filed Chapter 11 petitions in the U.S. Bankruptcy Court for the Southern District of New York in February 2016. Soon after that, the debtors and Residco entered into a Section 1110 Stipulation, pursuant to which the debtors returned the aircraft and rejected the Leases between April 2016 and October 2016. Given the then-market conditions associated with ERJ 145 aircraft, including the saturation of the market caused by Republic having rejected a significant number of its leases of such aircraft, the aircraft's actual value at the time of the debtors' lease rejec-

tion was significantly less than the parties anticipated at lease formation.

Residco filed proofs of claim aggregating over $55 million relating to the Leases and guarantees for alleged damages arising from Republic having rejected the Leases, a large part of which consisted of the anticipated residual value as reflected in the Leases' SLV liquidated damages formula.[55]

The debtors filed objections to Residco's claims, arguing that the actual lease-rejection losses were "readily calculable" and aggregated only $5.7 million.[56] The debtors ultimately filed their SJM, which was countered by Residco's opposition.

*Republic's SJM*

In their SJM, Republic asked the court to grant it a summary judgment denying Residco's liquidated damages claims, based on Republic's argument that (a) the Leases' liquidated damages provisions were unenforceable as against public policy because they violate Article 2A, and (b) because the liquidated damages remedies under the Leases were unenforceable, Residco's claims for such damages against the guarantor were also unenforceable.[57]

*Residco's Opposition*

In its objection to Republic's SJM, Residco countered Republic's assertions by arguing that the liquidated damages claims should be enforced because, among other things, voiding the liquidated damages provisions would violate the parties' freedom to contract, especially given the parties' sophistication and the complex nature of the underlying Article 2A "finance" leases.[58]

Further, with respect to the guarantees, Residco argued that under New York state law, the guarantees were "irrevocable" and "ironclad," and therefore RAH waived its right to any defense, including any defenses based on public policy.

*The Court's Holding*

After considering the arguments by both parties, the court granted Republic's SJM, finding that "the liquidated damages provisions in these leases are unenforceable because they violate Article 2A's requirement that they be reasonable in light of the then-anticipated harm from default."[59]

The primary focus of Republic's argument and the court's holding was the SLV component of the liquidated damages formula. Essentially, Republic argued, and the court agreed, that the SLV-based liquidated damages formula inequitably allocated to the Lessee the risk that the market value of the leased aircraft might significantly decline during the terms of the Leases.

The court found that this allocation was against public policy and may not be enforced against the Lessee, despite its contractual promise to pay the negotiated damages amount, or against RAH (as guarantor), despite its contractual promise to unconditionally guaranty the Lessee's payment of all amounts payable under the Leases, irrespective of any such defense.

## HOLDING REGARDING LEASE CLAIMS (AND WHY IT WAS FLAWED)

The court's refusal to enforce the SLV-based liquidated damages provisions in the Leases was based on its interpretation and application of UCC 2A-504. In reaching that decision, the court concluded that the SLV amounts included in the liquidated damages remedies were calculated to protect Residco's investment "regardless of where default may have left the parties,"[60] and that uncorrelated market factors were not linked to the default (i.e., the rejection of the leases).[61]

According to the court, the large disparity between the remaining rent amount and the corresponding SLV amount in the Leases' liquidated damages formulas evidenced that such formulas failed to satisfy the "reasonableness" requirement of UCC 2A-504.[62]

The court also concluded that although acceleration formulas may be enforceable for insurance purposes and as value protection under an early termination or other similar option,[63] SLV-based liquidated damages formulas are not necessarily enforceable because of the statutory reasonableness requirement.

The court begins its analysis by looking to Article 2A and the standards for liquidated damages before and after Article 2A's enactment. Although the court recognized that Article 2A significantly departed from pre-Article 2A tests that had included uncertainty and proportionality requirements, the court focused on 2A-504's retention of the reasonableness requirement as a justification for relying on pre-Article 2A case law.

With respect to the guarantees, Residco argued that under New York state law, the guarantees were "irrevocable" and "ironclad," and therefore RAH waived its right to any defense, including any defenses based on public policy.

Specifically, the court stated:

> In sum, the reasonableness requirement was part of the common law test predating Article 2A and remains part of the test today. Accordingly, the Court sees no reason why it would not consider prior case law on the reasonableness of liquidated damages, including the *TWA* decision, to be relevant and useful precedent.[64]

The court correctly notes that static or insufficiently declining liquidated damage clauses are inherently unreasonable.The liquidated damages at issue in the *Republic* case, however, declined monthly and could never fit into such an inherently unreasonable category.

As explained above, however, the problem with the court's reliance on *TWA* is that the Third Circuit in that case was clearly viewing the liquidated damages clause at issue through a pre-Article 2A lens.[65] As such, the Third Circuit made clear that it was not viewing the "reasonableness" of the liquidated damages in isolation from the prior (but now no longer used) uncertainty and proportionality requirements. Contrary to the court's determination, *TWA* is not relevant to post-Article 2A cases because it never considered Article 2A's significant departure from pre-Article 2A common law.

Moreover, the court gives short shrift to the reasons why Article 2A purposefully departed from Article 2 and prior common law tests for liquidated damages, failing even to mention the significant commentary on the purpose behind Article 2A-504's simplified liquidated damages test.

As also set forth above, and ignored by the court, Sec. 2A-504's official comments expressly state that this section's departure from prior, more stringent tests was compelled by, and critical to, modern leasing practice and to allow greater flexibility for leasing parties to liquidate damages (with the understanding that many leases are predicated on the parties' ability to liquidate damages).[66]

Moreover, while the court thereafter correctly recites current Article 2A standards, its recitation only underscores the problems with the court's conclusions. For example, the court recognizes that "reasonableness must be judged at the time of contract formation"[67] but supports its holding by referring to actual damages at the time of the breach,[68] which runs afoul of both the proper time to test the liquidated damages clause and reinserts into the analysis the discarded proportionality test.

The court also correctly notes that "sophistication of the parties may shed light as to what harms were actually anticipated when the deal was struck,"[69] but then fails to actually consider the fact that at the time of contract formation Republic was not only represented by counsel and financial advisors that created the base pricing model behind the SLV formula but also the fact that Republic itself was a seasoned industry participant that was well aware of aircraft values and, in fact, had originally purchased the aircraft that was later sold to the Lessor and leased back to Republic.[70]

In addition, the court correctly notes that static or insufficiently declining liquidated damage clauses are inherently unreasonable.[71] The liquidated damages at issue in the *Republic* case, however, declined monthly and could never fit into such an inherently unreasonable category.[72]

The court continues its one-sided analysis in its discussion of market risk allocation and determination that the parties cannot allocate risk without violating Article 2A-504's reasonableness requirement.[73] As an initial matter, the court misdescribes the liquidated damages as "transferring" the residual value risk upon default.[74] The Leases never *transferred* the risk of market decline; instead, the market risk allocation was both a material part of the parties' contract and a term the parties were free to (and did) negotiate. Ignoring such a negotiated material contract term also ignores a fundamental contract tenet: that contracting parties are entitled to the benefit of their bargain.[75]

Similarly, the court ignores the import of the parties' negotiated agreement when it rules that there is no causal link between anticipated harm and the debtor's default. Putting aside the fact that causation and intent are generally fact issues that should have precluded summary judgment, *any* default prior to the end of the Lease terms caused harm to Residco because Residco bargained for all the benefits associated with Republic's full payment and performance for the full term of each Lease.

Stated another way, Residco (and its predecessor-in-interest) agreed to invest in this transaction only because the Lessee agreed to satisfy *all* its lease obligations for the full term of the Leases. The nature of a default agreed by leasing parties as entitling a lessor to cancel or terminate a lease, or causing the same by operation of law (i.e., the rejection of a lease in a Chapter 11 case), is irrelevant in that the result remains the same — that is, the nonbreaching party is entitled to enforce its contractual damage remedy that included an anticipated residual value component (and the risk that the actual value of the leased property might decline below the parties' anticipated residual value).[76]

Under the court's analysis, if a lessee fails to insure leased aircraft (which is indisputably a material breach) but the aircraft suffers no damage, the lessor would be entitled to no damages at all, because failing to insure the aircraft would not cause a loss of rent or any other monetary harm, unless there were an accident or incident that occurred and the lessor is unable to recover from either the insurer or the lessee.

However, such an absurd result would render such leasing parties' agreement a nullity in a situation, even though no lessee could legitimately claim that the lessor acted unreasonably in deciding to enforce its rights to agreed damages as a result of the lessee's default (such as in the above example regarding failing to insure the leased aircraft).

Likewise, in *Republic*, Residco was harmed by the early termination of the Leases, resulting in Residco's failure to realize its entire bargain. That bargain included full and timely payment and performance by Republic of all its obligations for the entire scheduled term of each of the leases as well as return of the aircraft in the required condition after the Leases' terms expired.

Accordingly, Residco was entitled to enforce the liquidated damages formula in the Leases, which was intended to compensate Residco for damages the parties mutually recognized at lease commencement as approximating the damages Residco would suffer if the Leases were canceled or terminated prior to expiration.

The court's continued analysis further highlights its errors. For example, the court's lengthy comparison of remaining rent at the time of default to the liquidated damages amount[77] wrongly invokes the Article 2A-rejected proportionality test.

If the drafters believed that only rent (or even rent plus actual costs and damages from harm to the leased goods) were the sole recoverable amount for breach, the drafters could have easily expressly stated this — or not included a liquidated damages provision at all in Article 2A. In such a case, lease damages would simply equal rent, costs, and return of the goods (or if the goods could not be returned or were damaged, an additional amount to cover the goods' value at the time of the breach).[78]

Indeed, arguably the entire reason for having a liquidated damages clause is that contracting parties recognize some identifiable risk and wish to contractually allocate who bears such risk.

In addition, the official comments specifically provide an example of a common liquidated damages formula that includes "the lessor's estimated residual interest."[79] If the inclusion of such a common term was *per se* unreasonable, there is no point in citing this example without a statement that such component is not available under Article 2A.[80]

Further, in response to any doubt over Article 2A's drafters' statement that whether liquidated damages formulas such as the examples provided in the official comments 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,"[81] the most sensible way to interpret such a comment is that a formula where the residual interest component has no basis in fact (where, for example, the residual value is in excess of expert estimates) would be a situation where "the lessor's estimated residual interest" is not "reasonable in light of the anticipated harm."

The court's flawed analysis is also evident from the court's inability to find case support for its conclusion and its citation to inapposite cases or cases that support the validity of Residco's liquidated damages provisions. For example, the court cited *Northwest Airlines*[82] as an example of a case with purportedly similar liquidated damages as the leases.[83]

*Northwest Airlines*, however, relied on Minnesota common law that included the uncertainty test rejected by Article 2A[84] and addressed a *non*-declining SLV liquidated damages formula.[85] Because the liquidated damage formula in the Republic Leases declined monthly, there was no reason to cite *Northwest Airlines* or for the court's additional reference to the *TWA* decision (which, for the reasons stated above, has no relevance after the enactment of Article 2A) in support of rejecting "static margins or profit factors above and beyond compensation for loss."[86]

Nor was there a reason for the court to refer to cases where invalidated liquidated damages contained no provision to credit the leased equipment's value or disposal proceeds[87] or where the damages included *both* future rent and the stipulated loss value of the equipment.[88]

Notably, the court admits "that no court has *per se* rejected inclusion of residual interest liability in a liquidated damages provision"[89] but then nonsensically relies on a case that supports the SLV liquidated damages at issue in *Republic*.[90]

The court's lengthy comparison of remaining rent at the time of default to the liquidated damages amount wrongly invokes the Article 2A-rejected proportionality test.

Finally, the court unpersuasively determines that Article 2A-407's hell-or-high-water protections for finance lessors do not change the result because 2A-407 does not trump 2A-504's reasonableness requirement, and "such a reading would appear to violate the rules of statutory construction to read provisions in a harmonious manner."[91]

However, the obvious way to read these two statutory provisions in harmony is to give them both their intended meaning.

The two sections in fact complement each other in that 2A-504 allows lease contracting parties the freedom to allocate market value risk, and 2A-407 prevents lessees from escaping their contractual obligations once they accept the leased goods.

This holding is confounding because none of the cases cited by the court support its conclusion: there are no fraud, illegality, or limitations issues alleged by Republic in its motion for summary judgment.

Failing to read these two provisions in a truly harmonious manner simply encourages lessees to breach their lease whenever the leased equipment no longer fits their needs, or becomes obsolete, or when the assigned warranty protections prove ineffective. Such a reading is clearly untenable given the statute and the drafters' official commentary as detailed above.

As other courts, commentators, the Article 2A drafters, and Article 2A itself make clear, there is nothing penal about leasing parties making an informed business decision to allocate market value risk.[92] Quite to the contrary, Article 2A, in line with modern finance leasing practice, encourages such allocation. The court's unsupported conclusion finds a penalty where none exists.

## HOLDING REGARDING GUARANTY CLAIMS (AND WHY IT WAS FLAWED)

The court's results-driven analysis is equally apparent in the portion of the opinion addressing RAH's unconditional guarantees. Put simply, the court's refusal to enforce the guarantees was contrary to applicable law.

After rejecting the debtors' argument that the court use its equitable powers under Bankruptcy Code Sec. 105 and acknowledging that "New York law provides for stringent enforcement of unconditional guarantees,"[93] the court then contravenes clearly applicable law and determines that the guarantees violate public policy.[94]

Indeed, after string-citing a number of cases where New York courts and courts applying New York law unequivocally hold that unconditional guarantees foreclose affirmative defenses and counterclaims, *including* claims of fraudulent inducement into signing the guaranty itself,[95] the court then string-cites a number of cases that have nothing to do with the guarantees at issue in this case.

Just as the court repeatedly cited to static or other clearly distinguishable damage formulas in its liquidated damages analysis, the court cites to similarly inapposite cases in this section, such as:

(a) a case in which "a creditor's wrongful post-execution conduct triggered the event that accelerates or causes the guarantor's liability,"[96]

(b) cases discussing fraud,[97]

(c) cases where the court refused to enforce illegal contracts,[98] and

(d) a case barred by New York's statute of limitations applicable to guarantees.[99]

The court then holds that "[g]iven the weight of authority, this Court concludes that the Guarantees here are not enforceable for the same reason as the underlying obligations: the liquidated damages clauses in the Leases violate public policy."[100]

This holding is confounding because none of the cases cited by the court support its conclusion: there are no fraud, illegality, or limitations issues alleged by Republic in its motion for summary judgment.

Moreover, in 2016, the Second Circuit issued an opinion directly on point, *136 Field Point Circle Holding Company LLC v. Invar Int'l Holding Inc.*, 644 Fed. Appx. 10 (2d Cir. 2016), which supports the exact opposite conclusion reached by the court in *Republic*. In *136 Field Point,* the Second Circuit held that New York law barred an unconditional guarantor from raising the defense that the liquidated damages clause in the underlying guaranteed contract was an unenforceable penalty.[101]

The court's refusal to follow *136 Field Point Circle Holding Company LLC v. Invar Int'l Holding Inc.,* 644 Fed. Appx. 10 (2d Cir. 2016), underscores the court's disregard for any authority that supported enforcing the valid and enforceable guarantees.

As an initial matter, the court's dismissal of this admittedly on point case from the Second Circuit because the case is unpublished rings particularly hollow when the court had no issue with citing to and relying upon a transcript from the *Tidewater* bankruptcy case.[102]

In addition, the court's attempts to distinguish this on point case again underscore the unsupportable nature of the court's rulings. For example, the fact that the Second Circuit did not address any public policy argument is of no consequence because the Second Circuit's ruling inherently found that public policy was not contravened by enforcing the guaranty waivers under New York law.

Moreover, while it is self-evident that public policy is not contravened if New York law *repeatedly* enforces unconditional guarantees and will not even allow a fraudulent inducement claim to undermine such unconditional obligations, the court

itself recognized this fact when it quoted the following from *VNB New York Corp. v. M. Lichtenstein LLC,* 2011 WL 4024664, at *9 (Sup. Ct. Kings Cty. Sept. 8, 2011): "It is not against public policy to enforce a waiver of the right to interpose counterclaims … [and s]uch a waiver constitutes an insurmountable obstacle to defendants' attempt to assert these defenses and counterclaims."[103]

To make matters worse, the court then attempts to distinguish the cases cited by the Second Circuit in *136 Field Point,* which *enforced* unconditional guarantees, notwithstanding allegations and behavior in those cases far more concerning the facts in the *Republic* case (i.e., a liquidated damages clause entered into by sophisticated parties and sanctioned under applicable statutory law). Specifically, the court found that cases rejecting arguments that collusion and fraudulent inducement claims could invalidate an unconditional guaranty[104] did not support enforcing the guarantees, because these cases failed to invalidate guarantees "on grounds of public policy,"[105] which is a circular way of simply refusing to acknowledge that the New York law does not believe that unconditional guarantees violate public policy.

The court then continues its circular reasoning and to ignore the obvious conclusion that public policy is not violated by unconditional guaranties of obligations of this type when it states that post-*136 Field Point* cases are also distinguishable for the same reason — that is, because these subsequent cases uphold the guarantees, as opposed to invalidating them on public policy grounds.[106]

Arguably, the court's guaranty ruling is even less defensible than its liquidated damages ruling, where at least some support (no matter how outdated or misconstrued) existed. Here, however, there is no support whatsoever for the court's refusal to enforce the guarantees.

## PRACTICAL IMPLICATIONS AND SUGGESTIONS

It is extremely likely that debtors in bankruptcy and defaulting lessees outside of bankruptcy will continue to challenge SLV liquidated damages provisions where there is a large disparity between the anticipated residual value at lease formation and actual sale or rental proceeds obtained after leased equipment is sold or re-let after a lessee's default.

Although the authors disagree with the *Republic* case's holding, we do note that the *Republic* case — and cases cited by the *Republic* court in support of its holding — represent a risk to equipment lessors because these cases undermine the reliability of SLV-based liquidated damages clauses.

However, although these cases may be unsettling, we are not suggesting that lessors strike these provisions from the lease forms because, as noted above, we believe that they are consistent with UCC 2A-504.

Instead, and so long as lessors understand that courts may continue to invalidate these liquidated damages provisions (particularly when the value of leased goods substantially drops after lease inception), lessors should focus on those aspects of any liquidated damages formula that are likely to be scrutinized if challenged in an enforcement or bankruptcy case.

The formula should be calculated based on economics that have been mutually agreed upon by the parties. Fundamentally, the damages amount should be consistent with the lessor's achieving the benefit of its negotiated bargain as determined from time to time during the lease term to no lesser extent than would have been the case if the lease was not earlier canceled.

If an SLV-based formula is included, the SLV amount should take into account the lessor's economic expectations, which expectations are likely to include the lessor recovering the purchase price it advanced, its anticipated yield on that investment, any loss of assumed tax benefits, and some prepayment charge.

If the formula includes the accelerated remaining rent, it should be discounted to present value as of the date of determination using a reasonable discount rate. If the formula also includes the anticipated residual value of the aircraft at lease expiration, it should also be discounted at a reasonable discount date.[107] The formula should not be constructed in a manner such that, at lease commencement, the lessor would likely receive an amount that would constitute a windfall because of either an unreasonable anticipated residual value or double counting.

If an SLV-based formula is included, the SLV amount should take into account the lessor's economic expectations, … the lessor recovering the purchase price it advanced, its anticipated yield on that investment, any loss of assumed tax benefits, and some prepayment charge.

By way of example, an SLV-based component should not include an amount intended to cover lost tax benefits if the other formula components also included an income tax indemnification amount. Similarly, the formula should not include the disposition costs if that amount is also netted out of the mitigation credit.

Lessors should consider including in their lease forms acknowledgments or other assurances by their lessees supporting the enforceability of the liquidated damages formula. It might also be useful for lease forms to include an acknowledgment by a lessee that the lessor may avail itself of alternative acceleration remedies.

Most importantly, the lessor should not be entitled both to demand the formula amount and also to recover possession of the aircraft without a mitigation credit to be applied against the lessee's damages obligation. It would be advisable if the calculation of the mitigation amount is aligned with the calculation of the damages amount.

Accordingly, if the formula includes the present value of the accelerated remaining rent, the mitigation amount should also be comprised of the present value of the remaining rent under an actual or prospective re-lease of the equipment having similar terms to the canceled lease during a coterminous period.[108]

If the formula includes the anticipated lease expiry residual value, the mitigation amount should include the sales proceeds or a market sales value of the aircraft. If actually sold, the sales proceeds applied should be net of the disposition costs, sales, and other related reductions from the amounts received by the lessor in connection with the sale. If the equipment is not actually sold, the market value should take into account the actual condition of the aircraft; the likely disposition costs, taxes, and other charges; and the date on which the equipment might be available for a sale.

Lessors should consider including in their lease forms acknowledgments or other assurances by their lessees supporting the enforceability of the liquidated damages formula. It might also be useful for lease forms to include an acknowledgment by a lessee that the lessor may avail itself of alternative acceleration remedies, either detailed in the lease or otherwise available to the lessor under UCC 2A in the event that a court is unwilling to enforce the liquidated damages formula agreed to by the parties and set forth in the lease. By way of example, consider the following[109]:

> In furtherance of the foregoing, and as an inducement to Lessor to purchase and lease the Equipment to Lessee pursuant to this Lease, Lessee hereby acknowledges and agrees that:
>
> (i) the liquidated damages payable pursuant to this Section [__], (A) are to be paid in lieu of future Basic Rent, (B) are (as of both the date hereof, and the Acceptance Date) reasonable in light of the anticipated harm arising by reason of an Event of Default,[110] and (C) are not a penalty;
>
> (ii) Lessee's obligation to pay, and Lessor's right to receive, such liquidated damages in accordance with this Lease shall be absolute, irrevocable, independent, and unconditional and shall not be subject to (and Lessee hereby waives and agrees not to assert) any existing or future defenses or other Abatements[111] for any reason or under any circumstance whatsoever and is otherwise protected by the provisions of Section [__][112] hereof; and Lessee's agreement to pay such liquidated damages in accordance with the terms of this Section [__] was bargained for, understood and accepted by Lessee for all purposes, and shall be enforced in accordance with such terms by any court asked to consider the same;
>
> (iii) the occurrence of any one or more of the Events of Default shall be deemed, for all purposes, to substantially impair the value to Lessor of the transactions contemplated under the Lease Documents;[113]
>
> (iv) in the event that, notwithstanding the intent and express agreement of the parties, either the liquidated damages provision in this Section [__] is deemed noncompliant with applicable law, or circumstances cause it to fail of its essential purpose,[114] Lessor may exercise any of the other remedies provided herein, or available under UCC 2A or other applicable law (including the right to demand and be paid any or all of (A) all then accrued and unpaid Rent,[115] (B) the present value of all then unaccrued Basic Rent for the remaining Term, discounted at the Discount Rate, with an appropriate credit consistent with whether and how Lessor disposes of the Equipment, and (C) any incidental or consequential damages, less expenses saved by Lessor, if any, as a direct consequence of its cancellation of this Lease in connection with such Event of Default),[116] and
>
> (v) Lessor shall have no obligation to make any of the remittances to or apply any credits in favor of Lessee that are contemplated in this Section [__] if Lessor has paid such amounts to any other Person that has demanded and is entitled to the payment of such amount.

Finally, an approach discussed, but not necessarily endorsed, among the authors and other attorneys in the equipment financing industry is to include an acknowledgment in the lease by the leasing parties of the compensatory aspects of damage remedies, including any risk allocations. Any such acknowledgment would allow a court to understand the legitimate business purposes of the parties when they entered into the lease and agreed to those remedies, when asked to determine if the damages formula or amount was "reasonable" for the purposes of UCC Sec. 2A-504. Often in lease disputes, enforcement proceedings may take place decades after the effective date of such transactions.

Of course, any description of the risk and damage allocations should be drafted in a manner so as to avoid undercutting the true-lease nature of the lease transactions.

Perhaps memorializing this mutual business understanding with a sufficiently detailed acknowledgment might be more persuasive than hoping that a court would reach the desired conclusion by analyzing the calculations behind the SLV amounts listed on a lease schedule.

Such an acknowledgment might lessen or eliminate the need to prove the legitimate purposes of such damages and risk allocations, which may be very difficult (if not impossible) decades after the lease was documented. Of course, any description of the risk and damage allocations should be drafted in a manner so as to avoid undercutting the true-lease nature of the lease transactions.

Also, it is unclear from the *Republic* opinion whether that court would have come to any different conclusion if the risk were expressly acknowledged in the Leases, or if it would have considered any such acknowledgment of risk-allocation to be an admission that the basis for the liquidated damages was an inherent and intentional violation of public policy.

In sum, lessors should be mindful that the *Republic* case provided no reliable road map to avoid unfortunate decisions of this type in the future.

## CONCLUSION

The authors of this article believe that the *Republic* opinion reflects the result desired by the court and not the applicable law. It is our hope that most other courts, if asked to consider these same issues, whether under New York law or under the UCC and other commercial laws of other states, will reach conclusions consistent with the UCC 2A provisions and case law enforcing liquidated damages provisions with a residual value component.[117]

We also hope that the *Republic* court's refusal to enforce an unconditional and absolute guaranty governed by New York law remains an anomaly.

However, the *Republic* opinion represents a risk to equipment lessors until more reasonable decisions become available. Until such time, the *Republic* court's holding (as well as the *Tidewater and Montgomery Ward* decisions) may impair the extent to which lessors may rely on UCC 2A when drafting, negotiating, and agreeing upon the essential provisions of their leases and guaranties.

Lessors may consider various protective measures when compiling the transactional materials to keep in their files supporting the enforceability of its lease and guaranty documents. They may also consider addressing some of the matters raised by the court in its *Republic* holding by providing related acknowledgments, alternative remedies, and waivers, as referenced above.

### Endnotes

1. *In re Republic Airways Holdings Inc.*, 598 B.R. 118 (Bankr. S.D.N.Y. Feb. 14, 2019). Please note that one of the authors of (Arlene Gelman) and one of the contributors (Michael Edelman) to this article represented the lessor parties in this case, and that the parties settled their disputes shortly after the lessor parties filed a notice of appeal.

2. The Republic leases and the related transactions are described in the discussion of the pertinent facts later in this article.

3. *Republic,* 598 B.R. at 121. The court also considered what it referred to as a "secondary issue," whether the lessor had a valid administrative priority claim for post-petition rent relating to certain of the leased aircraft. Ibid. This article focuses only on the "primary" issues referenced above.

4. UCC § 2A-504(1); all references to "UCC" or "Article" refer to the Uniform Commercial Code, as adopted in the State of New York.

5. Article 2A became effective in New York on June 30, 1995 (1994 N.Y. Laws 114).

6. Unfortunately, as discussed below, the *Republic* court also relied upon cases interpreting and applying the pre-UCC 2A common law standards regarding the enforceability of liquidated damages remedies when holding that the liquidated damages formulas in the leases were invalid. Those pre-UCC 2A cases are referenced below as context for how and why the holdings of those cases should not have been viewed as persuasive authority with respect to the leases, all of which were entered into after UCC 2A was adopted in New York (the governing law state stipulated by the parties in the leases).

7. This characterization is determined for commercial law and bankruptcy purposes by the "bright line" and other tests and considerations in UCC 1-203 and related case law. Specifically, UCC § 1-203(b) provides that a security interest, and therefore not a true lease, is created if the lessee is obligated to pay rent for the lease term, if the lease is not subject to termination by the lessee and if: (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration; or (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. If the tests set forth in UCC § 1-203(b) are not dispositive as to the true-lease characterization, courts may consider (pursuant to UCC § 1-203(a)) pertinent case law, including cases examining the "economic realities" and other similar-purposed examinations of purported lease transactions. See *Ford Motor Credit Co., LLC v. Lasting Impressions Landscape Contractors, Inc. (In re Lasting Impressions Landscape Contractors Inc.),* 579 B.R. 43 (Bankr. D. Md. 2017); and *In re QDS Components Inc.*, 292 B.R. 313 (Bankr. S.D. Ohio 2002).

8. See, e.g., UCC § 2A-407 (commonly referred to as hell-or-high-water protections that make a lessee's contractual obligations irrevocable upon the lessee's acceptance of leased goods) and § 2A-523(f) (lessor's cumulative and expansive default remedies).

9. UCC § 2A-407.

10. See, e.g., UCC § 2A-301 (lease contract enforceable according to its terms); § 2A-501 (defaults may be determined by lease contract); § 2A-503 (parties may modify, substitute and add default rights and remedies in lease contract); and § 2A-523(f) (the lessor can pursue remedies in lease contract).

11. UCC Official Commentary to § 2A-101, § 2A-301 & § 2A-504.

12. See James J. White & Robert S. Summers, *Uniform Commercial Code* § 16:11 (6th ed., 2010) ("White and Summers"), citing to Official Comment 1 to UCC § 2A-503 ("Comment 1 to section 2A-503 explicitly embraces the broad view of freedom of the parties to agree on their remedies and, not too subtly, instructs the courts not to meddle with those restrictions. … Section 2A-503 authorizes many terms; it tells the courts that the drafters believe the world would be a better place if the courts did not intervene to remake the deal on the occasion of a dispute between the parties even long after the deal was made.").

13. UCC § 2A-501(1) ("Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article."). See also UCC § 2A-523. Referenced events of default in § 2A-523(1) include lessee's wrongful rejection or revocation of acceptance, failure to make a payment when due or repudiation, either with respect to the affected equipment or with respect to all of the equipment if the value of the whole lease is "substantially impaired."

14. UCC § 2A-505(1).

15. UCC § 2A-525(2) and (3).

16. UCC §§ 2A-503, 504, 527, 528 or 529 (as applicable).

17. UCC § 2A-528 (lessor damages include accrued and unpaid rent as of the date of default, the present value remaining, and any incidental damages allowed under § 2A-530 less expenses saved in connection with the default).

18. UCC § 2A-504, § 2A-103(4), and § 1-102(3).

19. UCC § 2A-503(1) provides that "[e]xcept as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article." See also UCC § 2A-528 (sanctioning additional, different remedies and damages by qualifying that remedies set forth thereunder govern default "[e]xcept as otherwise provided with respect to damages liquidated in the lease agreement (§ 2A-504) or otherwise determined pursuant to agreement of the parties (§§ 1-102(3) and 2A-503)").

20. UCC § 2A-108.

21. See White and Summers, citing to UCC § 2A-108 ("If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."). Also, assuming the liquidated damages remedy is exclusive, UCC § 2A-503(2) permits a party to pursue other UCC § 2A remedies if an exclusive remedy in a lease "fails for its essential purposes or provision for it is unconscionable."

22. UCC § 2A-504(2) (permitting the lessor to rely on the other statutory remedies (e.g., the acceleration remedies in UCC 2A-527, 528 and 529, as and to the extent applicable).

23. UCC § 2-718.

24. UCC § 2A-504(1) (emphasis added).

25. See UCC § 2A-504 Official Comments ("Subsection (1) is a significantly modified version of the provisions of Section 2-718(1)").

26. Ibid. See also Lawrence's Anderson on the Uniform Commercial Code § 2A-504:10 (3d ed., 2010).

27. UCC § 2A-504 Official Comments.

28. Ibid. Notably, UCC § 2A-504 also does not include UCC § 2-718's pronouncement that "[a] term fixing unreasonably large liquidated damages is void as a penalty."

29. See, e.g., *In re Dow Corning Corp.*, 419 F.3d 543, 549-50 (6th Cir. 2005) (addressing liquidated damages under common law test requiring satisfaction of the following conditions: "First, [(1)] the anticipated damages for a breach must be difficult or impossible to estimate. Also, [(2)] the amount of liquidated damages must be a reasonable forecast of the amount necessary to render just compensation. In addition, [(3)] 'liquidated damages must not be disproportionate to actual damages,' as measured at the time of the breach. Thus, if the liquidated damages are disproportionate to the actual damages, the clause will not be enforced and recovery will be limited to the actual damages proven.").

30. UCC § 2A-504(1).

31. UCC § 2A-504 Official Comments.

32. bid.

33. Ibid.

34. UCC § 2A-504(1). Notably, however, if the drafters believed any component of their listed examples was prohibited (e.g., anticipated residual interest), the drafters could have easily so stated.

35. A specified percentage to be multiplied against the lessor's acquisition cost and other capitalized amounts.

36. *Republic,* 598 B.R. at 133-34.

37. "Whether a contract clause which nominally prescribes liquidated damages is in fact an unenforceable penalty provision is a question of state law." *United Merchants & Manufacturers Inc. v. Equitable Life Assurance Society of the United States,* 674 F.2d 134, 141 (2d Cir. 1982).

38. See, e.g., *Wells Fargo Bank NW, N.A. v. U.S. Airways Inc.*, 2011 N.Y. Slip op. 52188, 2011 WL 6141034, at *4-5 (N.Y. Co. Supreme Ct. Dec. 1, 2011) (holding that holdover rent for aircraft calculated at twice the lease's regular monthly rental amount was a reasonable liquidated damages clause (not an unenforceable penalty) and noting that the leases "were negotiated by sophisticated persons in the airline industry with experienced counsel"); *In re Snelson,* 305 B.R. 255, 264-65 (Bankr. N.D. Tex. 2003) (upholding liquidated damages provision in lease for printing press and noting that liquidated damages provisions in a commercial contract negotiated by sophisticated parties are presumptively reasonable); *Atel Fin. Corp. v. Quaker Coal Co.*, 132 F. Supp. 2d 1233, 1241 (N.D. Cal. 2001) (rejecting liquidated damages claim in an enforcement case that had a number of particularly distinguishable facts, relying on cases and a California statute that related predominantly to loans, real estate leases and other transactions, and ignoring UCC-2A); and *Pacificorp Capital Inc. v. Tano Inc.*, 877 F. Supp. 180 (S.D.N.Y. 1995) (enforcing under pre-Article 2A law SLV liquidated damages provision in lease for computer equipment).

39. See, e.g., *In re Baez v. Banc One Leasing Corp.*, 348 F.3d 972 (11th Cir. 2003) aff'g, 226 F. Supp. 2d 1345 (N.D. Ga. 2002) (approving liquidated damages provision that protected the lessor for, among other things, residual value market risk); *PNC Equipment Finance, LLC v. MDM Golf, LLC,* 2016 WL 3453657 (S.D. Ohio June 20, 2016) (enforcing SLV liquidated damages provision); *VFS Leasing Co. v. S.T.I. Inc.*, 2013 WL 1352032 (N.D. Ala. Mar. 29, 2013) (enforcing SLV liquidated damages formula as reasonable under 2A-504); *Gen. Elec. Capital Corp., LLC v. G. Howard Assocs.*, 2010 WL 2346296, at *4-5 (E.D.N.Y. May 14, 2010) (enforcing SLV liquidated damages provision where lessee bears market value risk even though court applied more stringent and outdated common law requirements); *Red Line Air Inc. v. G. Howard Assocs. Inc.*, 2010 WL 2346299, at *3-4 (E.D.N.Y. May 11, 2010) (same); *In re Snelson,* 305 B.R. 255, 264-65 (Bankr. N.D. Tex. 2003) (enforcing liquidated damages provision that included anticipated value of equipment at end of lease term); *In re D & S Electrical/Mechanical Co. Inc.*, 297 B.R. 805 (N.D. Ala. 2003) (enforcing SLV liquidated damages provision after requiring that future rents be reduced to present value); *Sun v. Mercedes Benz Credit Corp.*, 254 Ga. App. 463 (2002) (enforcing liquidated damages formula with anticipated residual interest component after severing the one portion of the formula (extra monthly lease payment even though all past due and future lease payments were already included in the formula); *Winthrop Resources Corp. v. Eaton Hydraulics Inc.*, 2002 WL 3543165, at *8 (D. Minn. Apr. 23, 2002) (although the court used liquidated damages standards under pre-Article 2A standards with Article 2A-rejected tests, court still enforced SLV liquidated damages clause); *Case Credit Corp. v. Baldwin Rental Centers Inc. (In re Baldwin Rental Ctrs. Inc.),* 228 B.R. 504 (S.D. Ga. 1998) (enforcing liquidated damages formula including anticipated residual value component); *Coastal Leasing Corp. v. T-Bars Corp.*, 123 N.C.

App. 379 (1998) (enforcing liquidated damages provision that included residual interest (along with requirement to credit net sale or rental proceeds to amounts due) and noting 2A-504's expressed intent to promote leasing parties' freedom of contract); and *Wilmington Trust Co. v. Aerovias de Mexico, S.A. de C.V.*, 893 F. Supp. 215, 218-20 (S.D.N.Y. 1995) (enforcing SLV liquidated damages provision under stricter pre-Article 2A test).

40. *Case Credit Corp. v. Baldwin Rental Ctrs. Inc. (In re Baldwin Rental Centers Inc.)*, 228 B.R. 504, 509 (S.D. Ga. 1998). The *Baldwin* court further noted that the official comments' example liquidated damages provision "is identical to the provisions in the assumed leases with the only difference being that none of the figures in the comments are reduced to present value." Ibid., at 510.

41. See, e.g., *Wilmington Trust Co. v. Global Areo Logistics Inc.*, 2011 WL 11075177, at *3 (2011) (addressing static SLV formula that could never reduce below $34 million); and *In re Northwest Airlines Corp.*, 393 B.R. 352, 355 (Bankr. S.D.N.Y. 2008) (addressing a nondeclining SLV liquidated damages formula and utilizing Minnesota common law that included the uncertainty test rejected by Article 2A).

42. See, e.g., *Carter v. Tokai Fin. Servs.*, 231 Ga. App. 755 (1998) (liquidated damages formula provided that the lessor receive the present value for the equipment's anticipated residual value, but the lessor was not required to apply any net sales proceeds from the equipment's sale to amounts owed); see also *ePlus Group Inc. v. Panoramic Communications LLC*, 2003 WL 1572000 (S.D.N.Y. Mar. 27, 2003) (refusing to grant summary judgment for the lessor because question of fact existed regarding casualty value that included purported lost profits for quickly depreciating computer equipment).

43. See *Republic*, 598 B.R. at 131; *In re Tidewater Inc.*, No. 17-11132 (Bankr. D. Del. Aug. 30, 2017). Aug. 30, 2017 Hr'g Tr. at 76:7-12.

44. 145 F.3d 124 (3d Cir. 1998).

45. 326 F.3d 383 (3d Cir. 2003).

46. See *TWA*, 145 F.3d at 130 (noting the "precipitous downturn in the airline industry") and 135 (applicable lease "termination value" for aircraft equaled $13.5 million and estimated resale value for aircraft at time of return equaled $7 million).

47. *TWA*, 145 F.3d at 136 n.1.

48. *Montgomery Ward*, 326 F.3d at 386 & 391.

49. Ibid., at 391.

50. The summaries of the pertinent facts included in this article are based on details regarding the same in the *Republic* opinion and related pleadings. We have not included citations to any of the same.

51. Although the lessor parties to the Republic leases consisted of the owner trustee and the owner participant, this section of the article refers to "the Lessor" or "Residco" as the counterparty to the *Republic* leases for ease of reference.

52. *Republic*, 598 B.R. at 125.

53. Ibid. The court found it significant that "the liquidated damages clauses and the Schedule SLVs in the [Leases] are identical to those in the Original Leases — notwithstanding the previous rent payments made and the reduction in the residual value of the Aircraft between the Original Leases and the [Leases]."

54. Ibid., at 126.

55. Residco also filed an administrative expense claim seeking post-petition rent for certain of the aircraft (the "administrative expense claim").

56. Ibid., at 127. The debtors also argued that the administrative expense claim should be disallowed pursuant to the terms of the Section 1110 Stipulation.

57. The court also considered what it referred to as a "secondary issue," whether the lessor had a valid administrative priority claim for post-petition rent relating to certain of the leased aircraft. This article focuses only on the "primary" issues referenced above.

58. UCC § 2A-103(1)(g).

59. Ibid., at 121.

60. *Republic*, 598 B.R. at 134.

61. Ibid., at 135-38.

62. Ibid.

63. Ibid., at 138.

64. Ibid., at 131. To further support reliance on the *TWA* case, court cites to the transcript of an oral ruling of the Bankruptcy Court for the District of Delaware where that court determined that *TWA* was still good law notwithstanding Article 2A's enactment. *In re Tidewater Inc., et al.*, No. 17-11132 (Bankr. D. Del. Aug. 31, 2017), Aug. 30, 2017 Hr'g Tr. [ECF No. 497]. In addition to being wrong for the reasons set forth earlier in this article, the bankruptcy court in *Tidewater* stated its decision in a cursory ruling after oral arguments without providing a detailed written analysis. Ibid., at 76:7-16. Further, the *Tidewater* court ruled that the Third Circuit's *Montgomery Ward* decision controlled damages in that case, and as also explained earlier herein, the actual damages provided in the *Montgomery Ward* decision included "the then-present value of what would have been, when the lease terms began, the anticipated aggregate residual value of the leased equipment at the scheduled termination of the leases." *Montgomery Ward*, 326 F.3d at 391.

65. See, supra.

66. UCC § 2A-504 Official Comments.

67. *Republic*, 598 B.R. at 131.

68. Ibid., at 138 ("For these reasons, Residco is wrong in claiming that 'the Debtors' reliance upon the allegedly disproportionate actual damages has no bearing upon the enforceability of the Liquidated Damages Provisions under the Leases.'") (citing Residco's opposition brief).

69. Ibid., at 132.

70. See, supra.

71. *Republic*, 598 B.R. at 133.

72. See, supra, p. 9.

73. *Republic*, 598 B.R. at 133.

74. bid. ("At the center of the parties' dispute is the fact that the liquidated damages provisions here allow for the unconditional transfer of residual value risk, or market risk, only upon default, without a cognizable connection to any anticipated harm caused by the default itself."); ibid., at 134 ("In other words, in the event of a default, this remedy formulation effected a transfer of all market risk, or residual value, including any risk of idiosyncratic depreciation or damage to a particular Aircraft.").

75. Restatement (Second) of Contracts (1981) §§ 344 cmt A. ("Ordinarily, when a court concludes that there has been a breach of contract, it enforces the broken promise by protecting the expectation that the injured party had when he made the contract. It does this by attempting to put him in as good a position as he would have been in had the contract been performed, that is, had there been no breach. The interest protected in this way is called the "expectation interest." It is sometimes said to give the injured party the "benefit of the bargain.") and 347 cmt. A. ("Contract damages are ordinarily based on the injured party's expectation interest and are intended to give him the benefit of his bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he would have been in had the contract been performed.").

76. Stated another way, the equities associated with the allocation of value risk inherent in this SLV-based liquidated damages remedy do not turn on the nature of the breach. "The residual value guaranty represents part of the central economic bargain the lessee makes with the lessor in such leases: [I]f the lease goes to term, the lessor bears the risk of the property being worth less than it originally expected at the end of the term, but if the lease terminates early, this risk is borne by the lessee." Ian Shrank & Samuel Yim, Liquidated Damages in Commercial Leases of Personalty — The Proper Analysis, 64 Bus. Law. 757, 764 (May 2009). See also White & Summers § 16:13 ("Some believe that a liquidated damage clause allowing the lessor to recover the difference between the expected residual value and the actual residual value at the end of the lease might be unreasonable and so void. The suggestion is that a lessee should not be liable for high depreciation that arises out of market forces rather than out of unusual wear and tear. Those who advocate this position argue that these damages are not "reasonable in light of the … anticipated harm …" at the time the lease contract is entered into, as required by section 2A-504(l), because by their nature, they are unanticipated. *We disagree.*") (emphasis added).

77. *Republic*, 598 B.R. at 136-38. In addition, to the extent that the court was bothered by the inclusion of a 4% return in the SLV formula, the court could have easily severed this term and upheld the balance of the liquidated damages under UCC 2A-108.

78. See 2A-528.

79. UCC § 2A-504 Official Comments. Given the drafters' detailed comments to this section, it is reasonable to assume that the absence of such statement indicates that the drafters believed such remedy was available.

80. Given the drafters' detailed comments to this section, it is reasonable to assume that the absence of such statement indicates that the drafters believed such remedy was available.

81. Ibid.

82. 393 B.R. 352 (Bankr. S.D.N.Y. 2008).

83. *Republic,* 598 B.R. at 137.

84. In *Northwest,* the court ignored Article 2A's rejection of prior common law tests and, instead, believed that the proper standard was "that a liquidated damages clause is enforceable when (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation." 393 B.R. at 356 (internal quotation marks omitted).

85. Ibid., at 357 ("Here, however, damages never declined at all.").

86. 598 B.R. at 137.

87. Ibid., citing *Wells Fargo Equipment Finance Inc. v. The Woods at Newtown LLC,* 2011 WL 4433108, at *1 (S.D.N.Y. Sept. 23, 2011) (detailing liquidated damages formula that provided for no credit for equipment). The *Wells Fargo* court also invalidated the liquidated damages provision because actual damages were "readily ascertainable," ibid., at *5, and, thus, relied upon the uncertainty test that was purposefully omitted from 2A-504.

88. Ibid., citing *CIT Group/Equipment Finance Inc. v. Shapiro,* 2013 WL 1285269, at *7 (S.D.N.Y. Mar. 29, 2013) ("Damages comprising an independent sum for capital depreciation and future rent payments would impermissibly 'double-dip.'") (emphasis in the original).

89. 598 B.R. at 139.

90. bid., at 140, citing *Gen. Elec. Capital Corp. v, G. Howard Assoc. Inc.,* 2010 WL 2346296, at **4, 8 & n.9 (E.D.N.Y. May 18, 2010) (awarding liquidated damages under a stipulated loss value "formula that takes into account plaintiff's anticipated return of the aircraft initially financed at $3.1 million, the anticipated depreciation or residual value of the aircraft" and "defendants' previously paid rental payments" and explaining that the "stipulated loss value of the aircraft is the percentage of the capitalized lessor's costs of the aircraft determined by the applicable rent payment").

91. Ibid., at 142.

92. For any commentators that believe market risk allocation is impermissible because a lessor must bear risk in order for the contract to qualify as a true lease, this case provides a perfect example of how a lessor bears such risk under a true lease. Had the Lessee completed all its lease payments through the terms of the Leases and returned the aircraft at lease end, Residco would have been left with aircraft that all parties believed would be much higher valued when the Lessor agreed to purchase the aircraft at the Lessee's behest.

93. Ibid., at 145.

94. Ibid., at 147.

95. Ibid. at 145-46. The following is the court's own recitation of current New York law applicable to unconditional guaranties:

> [B]road, sweeping and unequivocal language in an absolute and unconditional guaranty generally forecloses any challenge to the enforceability and validity of the documents which establish defendant's liability for payments arising under the [underlying] agreement, as well as to any other possible defense to his liability for the obligations." *In re Nissan Litig.,* 2018 WL 2113228, at *5 (S.D.N.Y. May 8, 2018) (internal quotations omitted); see also *GSO Re Onshore LLC v. Sapir,* 29 Misc.3d 1234(A), 2010 WL 5071785, at *5 (Sup. Ct. N.Y. Cty. Nov. 24, 2010) (A "waiver-of-defenses provision … in a guaranty is valid and enforceable, and bars, as a matter of law, any defenses a guarantor might otherwise assert in an action to recover under its guaranty.") (citing *Citibank, N.A. v. Plapinger,* 66 N.Y.2d 90, 495 N.Y.S.2d 309, 485 N.E.2d 974 (1985); *Red Tulip LLC v. Neiva,* 44 A.D.3d 204, 842 N.Y.S.2d 1, 5-6 (1st Dep't 2007) ). "It is not against public policy to enforce a waiver of the right to interpose counterclaims … [and s]uch a waiver constitutes an insurmountable obstacle to defendants' attempt to assert these defenses and counterclaims." *VNB New York Corp. v. M. Lichtenstein LLC,* 32 Misc.3d 1240(A), 2011 WL 4024664, at *9 (Sup. Ct. Kings Cty. Sept. 8, 2011) (citations omitted). This is even the case for claims of fraudulent inducement of the guarantee itself. See *Plapinger,* 66 N.Y.2d at 95, 495 N.Y.S.2d 309, 485 N.E.2d 974 ("[T]he substance of defendants' guarantee forecloses their reliance on the claim that they were fraudulently induced to sign the guarantee. …"); *VNB New York Corp.,* 32 Misc.3d 1240(A), 2011 WL 4024664, at *10-11; *Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro,* 25 N.Y.3d 485, 493, 15 N.Y.S.3d 277, 36 N.E.3d 80 (2015). "To permit that [defense] would in effect condone defendants' own fraud in deliberately misrepresenting their true intention when putting their signatures to their absolute and unconditional guarantee." *Plapinger,* 66 N.Y.2d at 95, 495 N.Y.S.2d 309, 485 N.E.2d 974 (quotations omitted).

In addition to the court's cited cases, numerous other cases applying New York law uphold unconditional guaranties. See, e.g., 136 *Field Point Circle Holding Company LLC v. Invar Int'l Holding Inc.,* 644 Fed. Appx. 10 (2d Cir. 2016) (unconditional guaranty barred defense that liquidated damages in underlying obligation was an unenforceable penalty); *Duval v. Albano,* 2017 WL 3053157, at *13 (S.D.N.Y. July 18, 2017) ("Indeed, '[u]nder New York law, the only affirmative defenses that are not waived by an absolute and unconditional Guaranty are payment and lack of consideration for the Guaranty.'") (quoting *Overseas Private Inv. Corp. v. Moyer,* 2016 WL 3945694, at *4 (S.D.N.Y. July 19, 2016)); *Torin Assocs. v. Perez,* 2016 WL 6662271 at *4-6 (S.D.N.Y. Nov. 10, 2016) ("where a guaranty provides that it is 'absolute and unconditional irrespective of … any lack of validity or enforceability of the agreement'", such language "forecloses affirmative defenses and counterclaims," "which is why these provisions are colloquially called ironclad"); *County of Greene v. Chalifoux,* 127 A.D.3d 1316, 1317-18, 6 N.Y.S.3d 763, 764-65 (N.Y. App. Div. 3d Dep't 2015) (even if the principal could assert defenses based on public policy considerations, "a guarantor can be liable, despite the principal's escape from liability, if the guarantee contains language through which the guarantor expressly waives a right or defense"; thus, '"[t]he liability of the guarantor may be broader than and exceed the scope of that of the principal where the guarantee, which is a separate undertaking, clearly states that it is enforceable against the guarantor despite circumstances where liability would not attach to the principal'") (citations omitted); *Bank of Am., N.A. v Lightstone Holdings LLC,* 32 Misc. 3d 1244(A), 938 N.Y.S.2d 225, 2011 N.Y. Misc. LEXIS 4412, *13 (N.Y. Sup. Ct. July 14, 2011) (by executing unconditional guaranties, guarantors "waived their right to assert a public policy defense"); and *King v. Wells Fargo Business Credit Inc.,* 48 A.D.3d 643, 643, 852 N.Y.S.2d 349, 350 (N.Y. App. Div. 2nd Dep't 2008) (holding that an unconditional guaranty waived the defense that an early termination fee was an unenforceable penalty).

96. Ibid., at 146, citing *Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro,* 25 N.Y.3d 485 (2015) (affirming lower court's determination that allegations of collusion cannot overcome an absolute and unconditional guaranty and reiterating that fraudulent inducement is also no defense to guaranty liability).

97. Ibid., citing *Navarro,* 25 N.Y.3d 485 (2015) and *MCC Funding LLC v. Diamond Point Enters. LLC,* 2012 WL 2537893, at *5 (Sup. Ct. Kings Cty. June 25, 2012).

98. Ibid.

99. Ibid., at 147, citing *In re Dreier LLP,* 421 B.R. 60 (Bankr. S.D.N.Y. 2009). The *Republic* court cites to an additional

anomalous case, *Becker v. Rosenberg,* 711 F. Supp. 173, 174 (S.D.N.Y. 1989), where the Southern District of New York states without any citation to authority that if an underlying agreement cannot be enforced neither can a guaranty of such agreement and then goes on to enforce the guaranty in that case.

100. Ibid.

101. Ibid., at *12.

102. 598 B.R. at 131.

103. Ibid., at 145.

104. Ibid., at 147-48, citing Cooperatieve *Centrale Raiffeisen-Boerenleenbank; B.A. v. Navarro,* 25 N.Y.3d 485, 493, 15 N.Y.S.3d 277, 36 N.E.3d 80 (2015); and *Citibank, N.A. v. Plapinger,* 66 N.Y.2d 90, 495 N.Y.S.2d 309, 485 N.E.2d 974 (1985).

105. Ibid., at 148.

106. bid.

107. UCC § 2A-103(1)(u).

108. By "coterminous," we mean a term commencing on the date the equipment was released or available for release under a prospective re-lease, and expiring on the scheduled expiration date of the canceled lease.

109. The authors note that the sample text provided above is intended solely as an example of text that may be used to address certain of the issues raised in the *Republic* case, and is not intended to be exhaustive as to all of the related issues or as a recommendation as to how these issues should be addressed in any particular lease documents.

110. See the discussion above regarding UCC 2A-504's reasonableness test.

111. The term "abatements" when used in an equipment lease is often defined to include any abatement, reduction, setoff, defense, counterclaim, or recoupment with respect to any periodic rent or other payments due under the lease.

112. The hell-or-high-water section of the lease.

113. Consider the pertinent default trigger coverage in UCC 2A-523.

114. See, for example, UCC §§ 2A-523, 2A-525, and 2A-526, permitting a lessor to rely on the other statutory acceleration remedies in UCC §§ 2A-527, 2A-528 and 2A-529, as and to the extent applicable.

115. The term "Rent" as used in the above sample text is intended to include both scheduled, periodic rent as well as any and all other payments required under the lease (e.g., indemnifications, reimbursements, casualty payments, and enforcement or transactional costs.

116. Consider how this aligns with the above-referenced statutory acceleration remedies.

117. Again, so long the liquidated damages do not result in a windfall as a result of, for example, allowing for the double counting of damages or using a residual value that is in excess of a value justified by appraisals and/or market conditions at lease inception.

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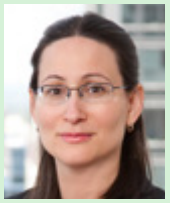

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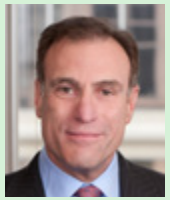

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Edward K. Gross is a shareholder in and founded the Washington, DC, office of Vedder Price P.C. He has more than 35 years' experience representing bank-affiliated and other large, independent, and captive financing providers in documenting, structuring, and negotiating equipment and tech solutions finance transactions.These transactions include construction and acquisition financings and monetizing existing assets of all types, including telecommunications, high-tech, agricultural, energy, and logistics equipment, as well as MES and bundled transactions. He has earned an international reputation, representing market-leading aircraft and helicopter financing providers, investors, and operating lessors, as well as large publicly or privately held businesses, government entities, and high-net-worth individual users of these assets. His asset-based capital markets practice includes securitizations, structured financings, portfolio purchases, back-leveraging, and discounting, participation, and other syndication transactions. Mr. Gross previously served on the board of trustees of the Equipment Leasing and Finance Foundation, and the ELFA Board of Directors and Legal Committee. He now chairs ELFA's Air, Rail and Marine Subcommittee. In addition to recognition by numerous national and international legal organizations, he received ELFA's Distinguished Service Award in 2008 and the Legal Committee's Edward A. Groobert Excellence in Leasing Award in 2011. He is also the immediate past chair of the UCC Leasing Subcommittee of the ABA Business Law Section as well as co-author of the leases article in the annual UCC Survey edition of the ABA *Business Lawyer.* Mr. Gross was awarded a BA from the University of Maryland in 1978 and a JD from the University of Baltimore School of Law in 1981.