Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.

361 N.E.2d 1015 (N.Y. 1977)

The principal issue on this appeal is whether a provision in a truck lease agreement which requires the payment of a specified amount of money to the lessor in the event of the lessee's breach is an enforceable liquidated damages clause, or, instead, provides for an unenforceable penalty.

Defendant Puritan Farms 2nd, Inc. (Puritan), was in the business of furnishing milk and milk products to customers through home delivery. In January, 1969, Puritan leased a fleet of 25 new milk delivery trucks from plaintiff Truck Rent-A-Center for a term of seven years commencing January 15, 1970. Under the provisions of a truck lease and service agreement entered into by the parties, the plaintiff was to supply the trucks and make all necessary repairs. Puritan was to pay an agreed upon weekly rental fee. It was understood that the lessor would finance the purchase of the trucks through a bank, paying the prime rate of interest on the date of the loan plus 2%. The rental charges on the trucks were to be adjusted in the event of a fluctuation in the interest rate above or below specified levels. The lessee was granted the right to purchase the trucks, at any time after 12 months following commencement of the lease, by paying to the lessor the amount then due and owing on the bank loan, plus an additional $ 100 per truck purchased.

Article 16 of the lease agreement provided that if the agreement should terminate prior to expiration of the term of the lease as a result of the lessee's breach, the lessor would be entitled to damages, "liquidated for all purposes", in the amount of all rents that would have come due from the date of termination to the date of normal expiration of the term less the "re-rental value" of the vehicles, which was set at 50% of the rentals that would have become due. In effect, the lessee would be obligated to pay the lessor, as a consequence of breach, one half of all rentals that would have become due had the agreement run its full course. The agreement recited that, in arriving at the settled amount of damage, "the parties hereto have considered, among other factors, Lessor's substantial initial investment in purchasing or reconditioning for Lessee's service the demised motor vehicles, the uncertainty of Lessor's ability to re-enter the said vehicles, the costs to Lessor during any period the vehicles may remain idle until re-rented, or if sold, the uncertainty of the sales price and its possible attendant loss. The parties have also considered, among other factors, in so liquidating the said damages, Lessor's saving in expenditures for gasoline, oil and other service items."

. . . After nearly three years, the lessee sought to terminate the lease agreement. On December 7, 1973, Puritan wrote to the lessor complaining that the lessor had not repaired and maintained the trucks as provided in the lease agreement. Puritan stated that it had "repeatedly notified" plaintiff of these defaults, but plaintiff had not cured them. Puritan, therefore, exercised its right to terminate the agreement "without any penalty and without purchasing the trucks". (Emphasis added.) On the date set for termination, December 14, 1973, plaintiff's attorneys replied to Puritan by letter to advise it that plaintiff believed it had fully performed its obligations under the lease and, in the event Puritan adhered to the announced breach, would commence proceedings to obtain the liquidated damages provided for in article 16 of the agreement. Nevertheless, Puritan had its drivers return the trucks to plaintiff's premises, where the bulk of them have remained ever since. At the time of termination, plaintiff owed $ 45,134.17 on the outstanding bank loan.

Plaintiff followed through on its promise to commence an action for the payment of the liquidated damages. Defendant counterclaimed for the return of its security deposit. At the nonjury trial, plaintiff contended that it had fully performed its obligations to maintain and repair the trucks. Moreover, it was submitted, Puritan sought to cancel the lease because corporations allied with Puritan had acquired the assets, including delivery trucks, of other dairies and Puritan believed it cheaper to utilize this "shadow fleet". The home milk delivery business was on the decline and plaintiff's president testified that efforts to either re-rent or sell the truck fleet to other dairies had not been successful. Even with modifications in the trucks, such as the removal of the milk racks and a change in the floor of the trucks, it was not possible to lease the trucks to other industries, although a few trucks were subsequently sold. The proceeds of the sales were applied to the reduction of the bank balance. The other trucks remained at plaintiff's premises, partially protected by a fence plaintiff erected to discourage vandals. The defendant countered with proof that plaintiff had not repaired the trucks promptly and satisfactorily.

At the close of the trial, the court found, based on the evidence it found to be credible, that plaintiff had substantially performed its obligations under the lease and that defendant was not justified in terminating the agreement. Further, the court held that the provision for liquidated damages was reasonable and represented a fair estimate of actual damages which would be difficult to ascertain precisely. "The parties, at the time the agreement was entered into, considered many factors affecting damages, namely: the uncertainty of the plaintiff's ability to re-rent the said vehicles; the plaintiff's investment in purchasing and reconditioning the vehicles to suit the defendant's particular purpose; the number of man hours not utilized in the non-service of the vehicles in the event of a breach; the uncertainty of reselling the vehicles in question; the uncertainty of the plaintiff's savings or expenditures for gasoline, oil or other service items, and the amount of fluctuating interest on the bank loan." The court calculated that plaintiff would have been entitled to $ 177,355.20 in rent for the period remaining in the lease and, in accordance with the liquidated damages provision, awarded plaintiff half that amount, $ 88,677.60. The resulting judgment was affirmed by the Appellate Division, with two Justices dissenting. (51 AD2d 786.)

The primary issue before us is whether the "liquidated damages" provision is enforceable. Liquidated damages constitute the compensation which, the parties have agreed, should be paid in order to satisfy any loss or injury flowing from a breach of their contract. . . .In effect, a liquidated damage provision is an estimate, made by the parties at the time they enter into their agreement, of the extent of the injury that would be sustained as a result of breach of the agreement. . . . Parties to a contract have the right to agree to such clauses, provided that the clause is neither unconscionable nor contrary to public policy. . . . Provisions for liquidated damage have value in those situations where it would be difficult, if not actually impossible, to calculate the amount of actual damage. In such cases, the contracting parties may agree between themselves as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury. . . .

On the other hand, liquidated damage provisions will not be enforced if it is against public policy to do so and public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority. . . . It is plain that a provision which requires, in the event of contractual breach, the payment of a sum of money grossly disproportionate to the amount of actual damages provides for penalty and is unenforceable. . . . A liquidated damage provision has its basis in the principle of just compensation for loss. . . . A clause which provides for an amount plainly disproportionate to real damage is not intended to provide fair compensation but to secure performance by the compulsion of the very disproportion. A promisor would be compelled, out of fear of economic devastation, to continue performance and his promisee, in the event of default, would reap a windfall well above actual harm sustained.

. . . The rule is now well established. A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. . . . If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced. . . .

In applying these principles to the case before us, we conclude that the amount stipulated by the parties as damages bears a reasonable relation to the amount of probable actual harm and is not a penalty. Hence, the provision is enforceable and the order of the Appellate Division should be affirmed.

Looking forward from the date of the lease, the parties could reasonably conclude, as they did, that there might not be an actual market for the sale or re-rental of these specialized vehicles in the event of the lessee's breach. To be sure, plaintiff's lost profit could readily be measured by the amount of the weekly rental fee. However, it was permissible for the parties, in advance, to agree that the re-rental or sale value of the vehicles would be 50% of the weekly rental. Since there was uncertainty as to whether the trucks could be re-rented or sold, the parties could reasonably set, as they did, the value of such mitigation at 50% of the amount the lessee was obligated to pay for rental of the trucks. This would take into consideration the fact that, after being used by the lessee, the vehicles would no longer be "shiny, new trucks", but would be used, possibly battered, trucks, whose value would have declined appreciably. The parties also considered the fact that, although plaintiff, in the event of Puritan's breach, might be spared repair and maintenance costs necessitated by Puritan's use of the trucks, plaintiff would have to assume the cost of storing and maintaining trucks idled by Puritan's refusal to use them. Further, it was by no means certain, at the time of the contract, that lessee would peacefully return the trucks to the lessor after lessee had breached the contract.

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Accordingly, the order of the Appellate Division should be affirmed, with costs.

Order affirmed.