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LANDLORD-TENANT

Fate of Acceleration Clause After Landlord Retakes the Property

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A common provision of a lease is an acceleration clause. An acceleration clause typically provides, in substance, that upon the tenant's default, the landlord may terminate the lease, and recover, as liquidated damages, the balance of the unpaid rent for the remainder of the term of the lease (had the lease not been terminated).

In the December 2014 decision of the New York Court of Appeals in *172 Van Duzer Realty v. Globe Alumni*,[1] one of the issues before the court was whether a lease's acceleration clause was per se invalid merely because the landlord terminated the lease and the tenant vacated possession of the leased premises. The Court of Appeals ruled that the acceleration clause was not rendered invalid simply because the tenant vacated possession of the property. The Court of Appeals, however, ruled that the defendants—the tenant and the guarantor—were entitled to a hearing on their contention that the undiscounted acceleration of all future rents constituted an unenforceable penalty.

'Van Duzer'

The relevant facts are as follows. In September 2006, 172 Van Duzer Realty, the owner of the premises located at 172 Van Duzer Street in Staten Island (landlord), entered into a commercial lease with Globe Alumni Student Assistance Association, as tenant (tenant), for a term of one year. The lease provided that the Globe Institute of Technology was to use the premises as a dormitory for its educational institution. Prior to the end of the one-year term, the parties entered into an agreement to extend the term of the lease for an additional nine years. In addition, at the time the extension agreement was entered into, Globe signed a guaranty that it would be jointly and severally liable for the tenant's obligations under the lease.

Within months after executing the lease extension, the landlord sent a notice to cure to the tenant, dated Jan. 30, 2008, claiming that the tenant had failed to maintain the premises in good order, based on the issuance of several violations issued by the New York City Environmental Control Board. The tenant failed to cure within the cure period, and instead vacated the premises and stopped paying rent as of February 2008. The landlord then proceeded to serve a notice terminating the lease, effective March 28, 2008, and thereafter commenced a holdover proceeding in the Civil Court to recover possession and past due rent. In August 2008, Civil Court awarded landlord possession of the premises, with a zero dollar money judgment.

In September 2009, the landlord commenced a plenary action in Supreme Court, New York County against both the tenant, and Globe as guarantor, for rent arrears and for the entire amount of future rent that would have been due for the remaining term of the lease had the lease not been terminated. The landlord based its claim for future rent on an acceleration clause in the lease which provided that upon the tenant's default, the landlord may terminate the lease, repossess the premises, and:

> shall be entitled to recover, as liquidated damages a sum of money equal to the total of … the balance of the rent for the remainder of the term.[2]

The same provision of the lease further provided that "[i]n the event of lease termination tenant shall continue to be obligated to pay rent and additional rent for the entire term as though th[e] lease had not been terminated."[3]

The landlord moved for summary judgment based on the terms of the acceleration clause. The defendants opposed the motion, maintaining that the landlord was prohibited from enforcing the acceleration clause once it terminated the lease and regained possession of the premises. The defendants also asserted that res judicata barred the landlord's claim for damages because the landlord purportedly could have obtained such relief in the Civil Court proceeding. In the alternative, the defendants requested discovery, in order to ascertain whether the landlord re-let the premises, in order to demonstrate the lack or proportionality between the landlord's claim for damages and its probable, actual loss.

Clause Upheld

Supreme Court (Justice Carol Edmead), in its decision dated Dec. 3, 2010,[4] granted the landlord's motion for summary judgment as to liability, finding that the parties had clearly agreed that the tenant would be liable for rent after termination of the lease, and referred the matter to a special referee to determine damages. Supreme Court cited to case law from the First Department, including *Ring v. Printmaking Workshop*,[5] which held that acceleration clauses providing for a tenant's continuing liability for rent after eviction are enforceable.

Supreme Court also denied defendants' request for discovery, concluding that under New York law, a landlord is entitled to collect full rent under the lease with no obligation to re-let, or attempt to re-let, the premises in order to mitigate damages. Supreme Court also rejected the defendants' reliance on res judicata, finding that (1) Globe was not a party to the Civil Court proceeding, and (2) defendants failed to establish that the issue of amounts due under the acceleration clause was necessarily decided in the Civil Court proceeding.

Thereafter, the parties stipulated to the amount of the landlord's damages in the sum of

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$1,488,604.66, consisting of the rent due under the lease for the balance of the term, less rent that the landlord collected on re-letting the premises for the period August 2008 through February 2011, plus interest.

Defendants appealed to the Appellate Division, First Department. In its decision dated Jan. 22, 2013,[6] the First Department affirmed, concluding that the landlord had made a "prima facie showing of its entitlement to accelerated rent, pursuant to the express terms of the lease…."[7] The First Department further found that the defendants "failed to raise a triable issue of fact as to whether the liquidated damages provision was an unenforceable penalty."[8] Finally, the First Department rejected the defendants' reliance on res judicata, "as such damages were not recoverable in the summary proceeding brought in the Civil Court."[9]

The Court of Appeals granted the defendants leave to appeal. On appeal to the Court of Appeals, the defendants again claimed that a landlord is barred from collecting future unpaid rent under an acceleration clause when the landlord terminates the lease and recovers possession of the premises.

Court of Appeals Affirms

In an opinion signed by Judge Jenny Rivera, dated Dec. 18, 2014, the Court of Appeals affirmed, except modified to the extent that the matter was remitted to Supreme Court for a hearing on defendants' claim that the acceleration clause constitutes a penalty.

The Court of Appeals rejected the defendants' contention that a landlord cannot claim accelerated rental payments if the landlord terminates the lease and regains possession. Among other things, the Court of Appeals found that the defendants had mistakenly relied on the Court of Appeals' 1979 decision in *Fifty States Management Corp. v. Pioneer Auto Parks*.[10] In *Fifty States*, the court held that an acceleration clause providing for accelerated rent upon a tenant's default in rent payment, as a condition of the tenant's continued possession of the property, was enforceable absent a claim of "fraud, exploitive overreaching or unconscionable conduct."[11] The court found that in *Van Duzer*, the "defendants do not argue that they want to be put back in possession."[12] The court further distinguished its prior holding in *Fifty States* by observing that:

> unlike the landowner in *Fifty States*, Van Duzer is not seeking to deploy the acceleration clause in the course of a continuing leasehold for purposes of ensuring the tenant's compliance with a material provision of the lease.[13]

The Court of Appeals further found that defendants could not challenge the validity of the acceleration clause based on the court's "recognition in *Fifty States* that, 'where a lease provides for acceleration as a result of any of its terms, however trivial or inconsequential, such a provision is likely to be considered an unconscionable penalty and will not be enforced by a court of equity'."[14] The court stated that while "[t]hat rule continues in force," it is "inapplicable to defendants, who committed material breaches of the lease by ceasing all rental payments as of February 2008 and simultaneously abandoning the premises."[15]

Furthermore, to the extent that defendants alleged that the landlord had a duty to mitigate, the Court of Appeals found that this argument had been rejected long ago in *Holy Props. v. Cole Prods*, in which the court stated that once a tenant abandons the property prior to expiration of the lease, a landlord is within its rights "'to do nothing and collect the full rent due under the lease.'"[16] The court stated that it saw no reason "to reverse course" in *Van Duzer*.[17]

> An acceleration clause in a lease will not be found to be unenforceable merely because the landlord has terminated the lease and retaken possession of the demised premises.

Penalty Issue

The court, however, found that the acceleration clause was subject to "judicial scrutiny" as to whether the future rent provided for under the clause was "grossly disproportionate to Van Duzer's actual losses, and therefore constitute an unenforceable penalty."[18]

The court found that defendants had on its face made a "compelling" argument that because the acceleration clause permitted the landlord to hold possession and immediately collect all rent due, the damages are grossly disproportionate to the landlord's actual damages. The court explained that it found this argument compelling because:

> arguably the ability to obtain all future rent due in one lump sum, undiscounted to present-day value, and also enjoy uninterrupted possession of the property provides the landowner with more than the compensation attendant to the losses flowing from the breach—even though such compensation is the recognized purpose of a liquidated damages provision.[19]

Thus, the Court of Appeals found that at the hearing before the special referee that Supreme Court directed to determine landlord's damages, "[d]efendants should have had the opportunity to present evidence that the undiscounted accelerated rent amount is disproportionate to Van Duzer's actual losses, notwithstanding that the landowner had possession, and had no obligation to mitigate."[20] As such, the Court of Appeals remitted to Supreme Court for further proceedings in accordance with the court's opinion.

Conclusion

The Court of Appeals in *Van Duzer*, agreeing with the Appellate Division, First Department, has confirmed that an acceleration clause in a lease will not be found to be unenforceable merely because the landlord has terminated the lease and retaken possession of the demised premises. The court, however, has left the door wide open for tenant challenges to an acceleration clause on the grounds that it constitutes an unenforceable penalty because the accelerated rent is grossly disproportionate to the landlord's actual losses.

It seems that in *Van Duzer*, the court found most "compelling" the fact that the acceleration clause at issue entitled the landlord to all future rent in a lump sum, undiscounted to present value. It would seem that a more typical acceleration clause entitling the landlord to future rent, but discounted to present value, might very well withstand any judicial inquiry.

1. 24 N.Y.3d 528 (2014).
2. Id. at 532-33.
3. Id. at 533.
4. 2010 WL 9479032 (Sup. Ct. N.Y. Co. 2010).
5. 70 A.D.3d 480 (1st Dept. 2010).
6. 102 A.D.3d 543 (1st Dept. 2013).
7. Id. at 544.
8. Id.
9. Id.
10. 46 N.Y.2d 573 (1979).
11. Id. at 534.
12. Id.
13. Id.
14. Id. at 535.
15. Id.
16. 87 N.Y.2d 130 (1995).
17. Id.
18. Id.at 536.
19. Id. at 536-37.
20. Id. at 537.