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Court of Appeals

STATE OF NEW YORK

THE TRUSTEES OF COLUMBIA UNIVERSITY
IN THE CITY OF NEW YORK,

Plaintiff-Appellant,

against

D'AGOSTINO SUPERMARKETS, INC.,

Defendant-Respondent.

BRIEF FOR PLAINTIFF-APPELLANT

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PRELIMINARY STATEMENT

In this commercial real estate dispute, The Trustees of Columbia University in the City of New York (the "University") submit this brief in support of an appeal from an order of the Appellate Division, First Department affirming a Supreme Court order that: (1) denied the University's motion for summary judgment on the complaint, and (2) granted the cross-motion of defendant D'Agostino Supermarkets, Inc. (the "Corporation") for: (a) summary judgment striking the University's claim for liquidated damages and (b) for entry of judgment against itself and in favor of the University for $175,751.73, with interest accrued from October 14, 2016 to the date of the judgment. In this appeal, the Court must decide whether the parties' carefully calibrated settlement agreement (the "Agreement"), which was negotiated by sophisticated commercial parties represented by counsel to resolve the Corporation's conceded default of a commercial lease (the "Lease"), contains an unenforceable penalty. It does not.

The provision in the Agreement bears none of the hallmarks of a penalty. The Agreement was designed to realign the parties' rights under the Lease to account for the risks both parties faced as a result of the Corporation's default under the Lease and the Corporation's request to be relieved of its past and future financial obligations under the Lease prior to its expiration, not to coerce compliance. Further, the University's actual damages are neither disproportional

to the amount ultimately owed under the Agreement, nor were the damages capable of being ascertained at the time the Agreement was executed.

After these two sophisticated, counseled parties entered into the "Lease", the Corporation defaulted, accruing over $260,000 in rent arrears. The Corporation approached the University seeking an early termination of the Lease, and after intense arms-length negotiations, the parties resolved their dispute by entering into the Agreement. The multi-faceted Agreement allowed the Corporation to surrender the premises prior to the expiration of the lease term and released the Corporation of its obligation to pay expenses, attorneys' fees and future rent under the Lease. The University abandoned many of its rights under the Lease and allowed the Corporation to merely pay the admittedly owed rent arrears via a payment plan over the course of one year. The Corporation agreed that, if it did not timely pay the rent arrears according to the terms of the Agreement, and did not cure the default after receiving a notice to cure, the Corporation would be responsible to the University for the amount that it already agreed to pay the University before the University agreed to enter into the Agreement, to wit, an amount equal to the future rent that would accrue under the Lease through the expiration of the term. Under this circumstance, the Corporation would no longer be liable for the unpaid back rent that it had agreed to pay in the Agreement.

This delicately balanced arrangement gave: (i) the Corporation, at its request, the ability to terminate its obligations under the Lease *prior to the expiration of the Lease term* without any additional consideration by merely paying the rent that was already owed; and (ii) an agreement that if the Corporation failed to pay, it would become obligated to pay, as liquidated damages, what it already previously agreed to pay the University in future rent under the Lease.

When the Corporation breached the Agreement, the University sought to enforce the terms of the Agreement and to recover an amount equal to future rent under the Lease. In the underlying litigation, the same attorney who negotiated the Agreement for the Corporation argued that the provision entitling the University to recover future rent was an unenforceable penalty.

A penalty does not exist when sophisticated parties, who are represented by counsel, enter into a settlement agreement bargained for at arm's length and agree to resolve a commercial real estate dispute by allowing one party to retain one of the rights it had previously bargained for in a commercial lease. The University twice bargained for the right to monthly rent from July 2017 to August 2018. All the Corporation had to do was pay the past due rent under the Lease to be absolved of any future obligations under the Lease. The right to receive rent under the Lease existed before the parties entered into the Agreement. The Agreement was not designed to coerce the Corporation into compliance, but to allow the University

to retain at least one of the benefits of its bargain in the event the Corporation breached its financial obligations under the Agreement. This Court has never held that retaining a pre-existing contractual right qualifies as a penalty.

The Agreement's conditional provision for future rent also served as a liquidated damages clause that estimated the University's damages flowing from the Corporation's breach of the Lease and the subsequent Agreement resolving that breach. At the time the Agreement was entered, it was impossible to predict precisely how much the University would suffer from the Corporation's repeated rent defaults and from losing a tenant from the Premises. The University had no way of knowing at the time the Agreement was entered: (i) state of the commercial rental market, (ii) whether it would be able to find a new tenant; (iii) how long it would take to find a new tenant; (iv) if it found a new Tenant, what the financial terms of a new lease would be; and (v) whether a new tenant would honor its financial obligations under a new lease. The parties nevertheless accurately approximated the University's losses, as demonstrated in the record by the $851,000 in actual damages actually sustained by the University as a result of the early termination of the Lease, which could have been much greater, and the approximately $1,200,000 in future rent due under the Agreement.

The Appellate Division refused to enforce the Agreement as these sophisticated parties and their counsel drafted it. The court analyzed the

Agreement, but ignored the context that gave birth to it in the first place. The Lease and the Agreement are inextricably intertwined, and the Appellate Division should not have treated them as separate and distinct agreements with no interrelation.

The Appellate Division decision, if it is left standing, will have a perverse, chilling effect on the commercial real estate industry in New York. If the Corporation can breach two agreements with impunity, commercial landlords will have no incentive to avoid litigation proactively by compromising with struggling commercial tenants, as the University did here, because sophisticated commercial tenants, like the Corporation in this instance, will have everything to gain and nothing to lose by breaching.

The Appellate Division compounded this error by granting the Corporation summary judgment. At most, the Appellate Division could only conclude that the damages provision was not enforceable as a matter of law and ordered a hearing to determine whether the University's actual damages were ascertainable at the time the Agreement was entered and proportional to the liquidated damages, in order to establish whether the provision was in fact a penalty.

The Appellate Division refused to order a hearing because it concluded, without any explanation, that the parties could not use the Agreement to compensate the University for the damages flowing from the Corporation's breach

of the Lease. The Appellate Division offered no justification for this assumption, and none exists. These sophisticated, counseled parties crafted a finely tuned Agreement to give the University the benefit of its bargain while simultaneously compensating it for damages in the event the Corporation breached its financial obligations under the Agreement.

Accordingly, this Court should reverse and grant the University's motion for summary judgment. In the alternative, the Court should order a hearing to determine whether the University's damages were ascertainable at the time of entry of the Agreement and proportional to the liquidated damages.

QUESTIONS PRESENTED

Did the Appellate Division incorrectly hold that the Agreement contained an unenforceable penalty?

Yes.

In the alternative, did the Appellate Division incorrectly refuse to remand the case to Supreme Court for a determination of the University's actual damages from the Corporation's breach of the Lease and the Agreement?

Yes.

FACTUAL AND PROCEDURAL BACKGROUND

A. The Lease Between The University And The Corporation

The University owns a building located at 2828 Broadway, New York, New York 10025 ("Building") (125).[1] In December 2002, the University and the Corporation – through counsel – began negotiating a lease of the ground floor and basement levels of the Building ("Premises"). The Corporation was presumably represented by its current counsel, Bruce Lederman, Esq., who was listed as the attorney to receive notices on behalf of the Corporation (109). The University and the Corporation entered into a written lease for the Premises (the "Lease") (125). The Lease was printed on the Standard Form of Store Lease, a 6-page template created by the Real Estate Board of New York, Inc. (42), but the parties, through counsel, made substantive changes to every page of the Lease (42-47).

The lease term commenced in August 2003 and expired in August 2018 (125, 165). In early 2004, the Corporation and the University subsequently revised the Lease by adding a 27-page rider ("Rider") (48-74) that superseded "any inconsistent provisions in the Lease" (48).[2] As provided in the Rider, the parties agreed to an escalating monthly rent and the cost of property taxes (52) and water

[1] Numbers in parentheses correspond to the pages of the record on appeal.
[2] The Lease and the Rider will be collectively referred to as the "Lease" when no distinction between the two is pertinent.

consumption (59) as additional rent. The Rider made other significant, substantive changes to provisions covering a wide range of topics (42-43).

One of the substantive topics the parties altered through negotiation was the University's rights in the event the Corporation failed to timely pay rent and additional rent (48). If the Corporation failed to pay any rent for 10 days after it was due, the rental arrears would bear an interest rate of 4% above the prime rate offered by Chase Manhattan Bank in New York City (48). The interest on the rent arrears would become "additional rent" (48).

In addition, the parties established one set of remedies for a non-monetary default (44), and another for a monetary default (60), which excluded minor, technical breaches. The parties agreed that a monetary default would occur if the Corporation did not pay rent in (i) "two (2) consecutive months or for a total of three (3) months in any period of twelve (12) months or (ii) more than three (3) times, in the aggregate, in any period of six (6) months" and failed to cure after receiving notice (60) (Article 46).

In the case of a monetary default, the Corporation would pay all "rent and additional rent" that had accrued until the time the University re-entered the Premises became due (44) (Article 18[a]). The University and the Corporation further agreed that, upon re-entering, the University could re-let the Premises, but had no obligation to do so (44) (Article 18[b]). The parties agreed the University

could grant "concessions" or "free rent" to induce a new tenant to take possession (44) (Article 18[b]).

In the event of a default, the Corporation agreed to pay the University any deficiency between the new rent and the Corporation's rent that occurred during the lease period (44) (Article 18[c]). The parties further agreed that in addition to such deficiency, the Corporation would pay the University's expenses associated with re-letting the Premises, such as legal expenses, attorneys' fees, brokerage fees, advertising costs, and the cost to maintain the property in "good order" while seeking a new tenant (44) (Article 18), (60) (Article 46.04).

The Agreement provided that abandoning the Premises would constitute a default by the Corporation for a "failure to do business" (56) (Article 43.03). The parties reached this agreement "[b]ecause of the difficulty or impossibility of determining [the University]'s damages by way of loss of anticipated percentage rent from other tenants or occupants in or adjoining the Building, or by way of loss of value in the Building because of diminished saleability, mortgageability or adverse publicity or appearance by [the Corporation]'s actions" (56) (Article 43.03).

B. The Corporation Defaults On The Lease, Attempts To Abandon The Premises, And Executes The Agreement

Although the University complied with all its obligations under the Lease, the Corporation stopped paying rent (166). Arrears eventually exceeded $261,000,

the equivalent of over seven months of rent (48, 166). In early 2016, the Corporation contacted the University in an attempt to reach an agreement allowing the Corporation to abandon the Lease two years prior to the expiration of the term and resolve the conceded arrears. During the negotiations, the Corporation continued to miss rent payments. The University, in turn, began searching for a new tenant.

After extensive arms-length negotiations conducted through counsel, the parties entered into the Agreement, which resolved the Corporation's breach of the Lease prior to litigation, surrendered the Premises back to the University and released the Corporation from its obligations under the Lease, even though the University had not yet signed a lease with a new tenant. (105-111). Under the Agreement, the parties released each other of some obligations, retained others and replaced others, all to adjust to the commercial realities occasioned by the Corporation's breach. For example, under the Agreement, the University agreed to release the Corporation from its contractual obligations and allowed the Corporation to surrender the Premises on May 31, 2016. The Corporation agreed to pay the University the $261,000 in rental arrears that had accrued by the time of surrender (125, 105, 166).

The parties also retained some rights under the Lease on a contingent basis. The University agreed to give up many of its rights under the Lease due to the

Corporation's conceded breach, but only on the condition that the Corporation timely pay the $261,000 in rent arrears in installments over the next year according to the following schedule: (i) $43,000.00 concurrent with the execution of the Agreement (the "Initial Payment"); (ii) a payment of $43,000.00 on or before June 1, 2016 (the "Second Payment"); and (iii) payments of $15,977.43 on the first day of each month during the period commencing on July 1, 2016 and ending on May 1, 2017 (the "Monthly Payments") (48, 105-106). Because the $261,000 was for rent arrears, the parties expressly recognized that "time was of the essence" (106). If the Corporation complied with the Agreement and paid the past rent, it would be released of any claims arising from its past breach of the Lease and from the obligation to pay future rent (106).

But if the Corporation surrendered the property and broke its promise to pay the rent arrears, the University would give up its right to seek damages for the losses that had already occurred, such as the $261,000 of rent arrears, interest provided in the Lease (4% above prime), expenses the University would have been entitled to under the Lease (48, 105-107, 127), and harm caused to the University's other property by a vacancy (56, 107). In exchange, the Corporation agreed to pay the University all the rent and additional rent the Corporation would have paid under the Lease from June 2016 through August 2018 when the Lease expired, which amounted to approximately $1.2 million (106-107).

This arrangement served a dual purpose. First, it gave the University, which gave up many of its rights under the Lease, at least one benefit of its bargain, either past or future rent. For example, the University agreed to release the Corporation from its contractual obligations on May 31, 2016 – over two years before the term of the Lease was set to expire (106). The University also gave up its right to the Lease's liquidated damages provision, which required the Corporation to pay expenses associated with re-letting the premises, "such as legal expenses, attorneys' fees, brokerage, advertising and for keeping the demised premises in good order or for preparing the same for re-letting" (44, 60). The University gave up its right under the Lease to obtain interest at 4% over the prime rate on late rent (48). Thus, the University gave up nearly all of its rights in the Lease in exchange for the Corporation's promise to give the University at least one benefit of its bargain, either past or future rent.

Second, the amount of future rent approximated the University's damages for the Corporation's breach of the Lease and the Agreement. The University, its counsel, the Corporation, and its counsel, Mr. Lederman (who continues to represent the Corporation on this appeal) crafted this arrangement to account for the commercial realities occasioned by the Corporation's breach of the Lease and for the uncertain damages that the University might suffer in the future. For example, at the time of the agreement, the University had no guarantee that it

would have a new tenant after the Corporation abandoned the Lease on May 31, 2016. As the parties acknowledged at the inception of this commercial relationship, a vacancy in the Premises had the potential for "damages by way of loss of anticipated percentage rent from other tenants or occupants in or adjoining the Building, or by way of loss of value in the Building because of diminished saleability, mortgageability or adverse publicity or appearance by [the Corporation]'s actions…" (56) (Article 43.03). Further, the University had no way to guarantee that a new tenant, if any, would agree to pay the same rent or greater than the Corporation's rent or what other financial concessions a new tenant would demand. The Agreement accounted for the commercial realities at that time, including the fact that the University was still negotiating with prospective new tenants.

Consequently, the University risked that the Corporation would timely pay the installments for rent arrears, freeing itself of the Lease obligations, and the University would be unable to find a satisfactory tenant. Having freed the Corporation of any further responsibility under the Lease, this was among the worst-case scenarios for the University.

The parties executed the Agreement on May 27, 2016. The Premises remained vacant for a month until the University signed a lease with a new tenant on June 30, 2016 (221).

C. **The Corporation Defaults On The Agreement**

The Corporation timely made the Initial Payment of $43,000 at the time of the Agreement on May 27, 2016 and the Second Payment of $43,000 on June 1, 2016 (126). But the Corporation did not make *any* of the first three Monthly Payments, which were due July 1, August 1 and September 1 (105, 126). The University did not serve a notice of default until the Corporation missed its fourth consecutive Monthly Payment, when the Corporation's actions made clear that it did not intend to honor the Agreement (126). Two weeks after the fourth consecutive missed payment, the University sent the Corporation a letter dated October 14, 2016 notifying the Corporation that it had defaulted on the Agreement (the "Notice") (126, 130-132). Although the University had performed all its obligations under the Agreement, the Corporation nevertheless failed to pay the Defaulted Monthly Payments within five (5) business days of the Notice (127). Upon the Corporation's default, the Agreement relieved the Corporation of rent arrears, interest and expenses that had accrued before the Agreement and replaced it with the obligation to pay the University the amount of future rent that would have accrued under the Lease from June 2016, when the Corporation abandoned the premises, to August 2018, when the Lease would have expired (48, 106, 127).

D. The University Commences This Action

1. The Original Summons And Complaint

The University commenced this action in November 2016 by serving and filing a summons and complaint (33). The complaint annexed as exhibits the Lease (42-47), the Rider (48-104) and the Agreement (105-113).

The complaint asserted three causes of action. In the first cause of action, the University sought $1,029,969.54 for breach of the Agreement (36-38), where the parties agreed that if the Corporation defaulted, it would pay the University the aggregate amount of fixed rent the University would have received under the Lease from June 2016 to August 2018 (38). In the second cause of action, the University sought an amount to be determined at trial for the Additional Rent the University would have received under the Lease (38-39). For the third cause of action, the University sought an amount to be determined at trial for the water and sewer charges the Corporation agreed to pay as Additional Rent under the Lease (39-40).

2. The Answer

The answer denied the material allegations in the complaint (118-120). The answer denied knowledge and information sufficient to form a belief as to whether the Corporation made Monthly Payments as required by the Agreement (119). The answer asserted nine boilerplate affirmative defenses (121).

3. The University's Motion For Summary Judgment

The University moved for summary judgment on December 19, 2016. In support, the University submitted the affidavit of Ann E. Lubell, its Executive Director for Real Estate and the affirmation of David M. Grill (124-128), each with accompanying exhibits. In the affirmation of David M. Grill, the University argued that this action is a "straight forward breach of contract action" in which the parties do not dispute that the Corporation failed to make the Monthly Payments required by the Agreement (23-24). As compensation, the University sought an order (1) granting the University summary judgment on liability in the amount of $1,020,125.15, which represents the monthly rent the University would have received from June 2016 until the end of the lease period in August 2018 (22, 127); (2) severing the second and third causes of action and directing an inquest to compute the precise amount of damages; (3) dismissing the Corporation's affirmative defenses; and (4) granting the University any other relief the Court deemed appropriate (128).

4. The Corporation's Failed Attempt To Comply With The Agreement

Instead of responding to the University's summary judgment motion, the Corporation amended its answer (145-150) and sent the University a check, dated December 29, 2016, for $175,751.73 (52). This amount purported to cover all eleven Monthly Payments the Corporation agreed to pay in the Agreement,

including the six Monthly Payments the Corporation missed and the five Monthly Payments that had not yet come due (52, 105).

5. The Amended Answer

The amended answer asserted three new affirmative defenses and a counterclaim. In the counterclaim for unjust enrichment, the Corporation alleges that the University has "been enriched by re-leasing the premises during [the Corporation]'s lease term" (149). According to the counterclaim, the University "has successfully re-leased the premises to a new tenant" and it would be "against equity and good conscience to permit [the University] to retain the rent payments from the new tenant while concomitantly obtaining damages from [the Corporation] derived from the same premises" (149).

6. The Corporation's Opposition And Cross Motion For Summary Judgment

The Corporation opposed the motion and cross-moved for summary judgment striking the University's claim for liquidated damages and entering a judgment against itself for $175,751.73 – the amount representing past rent due under the Agreement (158-208). In the alternative, the Corporation sought discovery on the issue of damages (158). In support, the Corporation submitted the affidavit of Nicholas D'Agostino. In the affidavit, Mr. D'Agostino identified himself as the Chief Executive Officer of the Corporation (160). According to Mr. D'Agostino, G. Robert James, the Corporation's then-president and chief operating

officer, "attempted to reach out to the landlords of stores operating at a loss and negotiation, among other things, to surrender stores on mutually acceptable terms (166). After months of negotiation, the Corporation and the University agreed to the payment schedule set forth in the Agreement (166-167). Mr. D'Agostino conceded that the Corporation did not timely make the Monthly Payments (167) allegedly because the Corporation "did not have sufficient funds on hand to continue operating" (164).

According to D'Agostino, in December 2016 – after the Corporation missed every one of the five Monthly Payments that had become due, the University commenced this action and the University moved for summary judgment – the Corporation "arranged to borrow the full amount" owed and attempted to tender it to the University (168). In an attempt to explain why the Corporation defaulted, Mr. D'Agostino claimed that he and Mr. James "did not focus and fully appreciate the possible implications of the default provisions" that required future rent upon default of the Agreement (167). Mr. D'Agostino's affidavit omits that, at the time of the Agreement, the Corporation was represented by Bruce Lederman – the same attorney representing the Corporation in this litigation.

Although Mr. D'Agostino admitted the Corporation's default, he argued that the Agreement was unenforceable for two reasons. First, the Agreement does not use the phrase "liquidated damages." (167). Second, the University found a new

tenant for the Premises and, therefore, "it is only logical and fair that [the Corporation] get credit for the damages which would have been mitigated as a result of re-renting" the Premises (167-168). Mr. D'Agostino did not address the fact that, under the Lease, the University had no duty to mitigate damages, yet the University gave up that right under the Agreement and accepted all the risk of finding a new tenant in exchange for the Corporation's promise to timely pay off the rent it already owed.

The Corporation also submitted an affidavit from its Senior Director of Store Operations, Robert Del Sole. Mr. Sole's affidavit incorrectly alleges "Columbia secured a new tenant for the Surrendered Store before it was surrendered" by the Corporation (185). In support of this contention, Mr. Sole annexed an e-mail between him and University employee, Anil Chandra, in which Mr. Chandra asks "The new tenant wants to know if you are leaving the baler and conveyor belt[?]" (186-187). Mr. Sole therefore concluded that, at the time of the Agreement, the University could have ascertained its actual damages if the Corporation defaulted (186).

Finally, the Corporation submitted the affidavit of Richard Cabassa, Director of Operations (188-189). Mr. Cabassa stated that, in April and May 2016, he accompanied various prospective tenants and University representatives to inspect the Premises (188). One of the prospective tenants "appeared to be of Asian

decent" and mentioned H-Mart (189). Mr. Cabassa stated he was "informed" by an unspecified source that H-Mart has signed a long-term lease "at or around the time the [Corporation] surrendered" the Premises (189). Mr. Cabassa annexed to his affidavit a work permit filed by Lihong Zhang of Shong Tao Group Corp. and approved by the New York City Department of Buildings ("DOB") in September 2016 (189-200).

7. **The University's Reply**

In reply, the University emphasized the policy arguments in support of enforcing the Agreement negotiated and drafted by the Corporation, the University and their respective counsel. The University explained that it went to great lengths to assist the Corporation "in ending its leasehold obligations early," even though the University, "upon being told that [the Corporation] wanted to get out of its Lease, could easily have enforced its rights under the Lease which would have required [the Corporation] to pay all rents due thereunder" (212). Instead, the University proactively sought to resolve the dispute, but in response, the attorney who negotiated the Agreement for the Corporation subsequently argued that the Agreement is unenforceable (212-213).

The University argued that the Corporation would receive a windfall if it were released from its obligations under the Lease in exchange for paying only the rent that it already owed, without the interest or expenses. Moreover, failing to

enforce the Agreement as written would have a chilling effect on landlords who attempt to accommodate failing tenants by resolving disputes proactively and violate the public policy favoring settlement agreements (213, 217).

The reply also addressed the Corporation's counterclaim and cross motion for summary judgment. With regard to the Corporation's counterclaim, the University explained that the Corporation's unjust enrichment claim contradicts the premise of the Agreement and, in any event, fails as a matter of law because a valid contract on the same subject matter exists. With respect to the cross motion, the University argued that if the Agreement were found to be unenforceable, "additional proceedings as to [the University]'s actual damages will be necessary" (218).

The University also submitted the affidavit of Anil Chandra, Assistant Director, University Acquisitions and Leasing. Mr. Chandra explained that the University negotiated the terms of a new lease with a new tenant in May and June of 2016, and executed a lease with a new tenant on June 30, 2016 (221). Therefore, the University had not secured a new tenant at the time the Agreement was executed. Mr. Chandra clarified that his May 23, 2016 e-mail to Mr. Del Sole referred to a prospective tenant, not an actual tenant (221).

Finally, Mr. Chandra described some of the losses the University suffered as a result of the Corporation's default. He explained that as a result of the

Corporation's default, the University lost $175,751.73 in past rent from the Corporation, approximately $300,000 lost rent or free rent to induce a new tenant to enter into a lease, $200,000 in broker commissions, and $90,000 in attorneys' fees (223).

E. Supreme Court Order

Supreme Court, New York County (Scarpulla, J.), by order dated February 5, 2017, (1) denied the University's motion for summary judgment; (2) granted the Corporation's cross motion for summary judgment; (3) awarded the University $175,751.73, plus interest from October 14, 2016 to the date of the judgment; (4) dismissed the Corporation's counterclaim; and (5) ordered the clerk to enter judgment accordingly (16-17). Supreme Court reasoned that at the time of the Agreement, "in May 2016, one month before the new tenant re-let the [ ] Premises, the [University] plainly had sufficient information to make a reasonable calculation of its potential damages from [the Corporation]'s early surrender of the Lease" (13). According to Supreme Court, the University deemed $261,751.73 (the amount due under the Agreement) "to be fair compensation sufficient to allow [the Corporation] to surrender the Lease" (13). Thus, the Court concluded the "Agreement's liquidated damages clause, which is not related in any way to the total amount due under the [ ] Agreement, was therefore plainly a penalty aimed at

ensuring [the Corporation]'s performance via threat of an outsized damages award" (13).

Supreme Court rejected the University's argument that Agreement was not a penalty because it simply put the parties back to their original positions (14). The Court reasoned that enforcing the Agreement "would result in an award of five and a half times the amount that the Trustees of Columbia would have received if [it] had been fully performed" and therefore "does not reasonably relate to the potential harm" the University suffered from the default (15).

F. <u>The Appellate Division Order</u>

The University appealed. The Appellate Division, First Department (Friedman, J.P., Gische, Kapnick, Gesmer and Moulton, JJ.) affirmed without costs (233-235). The First Department held that the "damages at the time of the [ ] Agreement were ascertainable" and concluded that the University's "attempt to enforce the liquidated damages provision sought to secure performance by threat of a large payment rather than to provide a reasonable assessment of probable damages" (234-235) (internal citations and quotation marks omitted). The First Department further held that "the liquidated damages provision is unenforceable as 'unreasonable and confiscatory,' since it would result in an award 7 ½ times the amount" the University would have received if the Agreement had been fully performed (235). The Appellate Division did not explain why it refused to

consider the damages the University had suffered from the Corporation's default of the Lease, which was the reason the Agreement existed in the first place.

The University moved for leave to appeal, and this Court granted the motion (236).

ARGUMENT

POINT I

THE AGREEMENT ENFORCED PRE-EXISTING CONTRACTUAL RIGHTS AND APPROXIMATED THE UNIVERSITY'S ACTUAL DAMAGES WITHOUT IMPOSING A PENALTY

A. General Legal Principles

"In New York, agreements negotiated at arm's length by sophisticated, counseled parties are generally enforced according to their plain language pursuant to our strong public policy favoring freedom of contract." 159 MP Corp. v Redbridge Bedford, LLC, -- NY3d ---, 2019 NY Slip Op 03526 at *1 (May 7, 2019). New York courts closely adhere to this principle given "New York's status as the preeminent commercial center in the United States, if not the world." 159 MP Corp., 2019 NY Slip Op 03526 at *6. The reason for this public policy is manifest: an agreement is essentially "a bargained-for exchange between the parties" (Rowe v Great Atlantic & Pac. Tea Co., Inc., 46 NY2d 62, 67 [1978]), and honoring that bargain "promotes certainty and predictability and respects the

autonomy of commercial parties in order their own business arrangements." 159 MP Corp., 2019 NY Slip Op 03526 at *7.

The importance of this public policy is magnified "in the context of real property transactions, where commercial certainty is a paramount concern[.]" Vermont Teddy Bear Co. v 538 Madison Realty Co., 1 NY3d 470, 475 (2004). Recognizing the importance of certainty and predictability in the commercial real estate context, this Court has routinely enforced leases as drafted by sophisticated, counseled businesspersons. See, e.g., 159 MP Corp., 2019 NY Slip Op 03526 (enforcing waiver of right to commence a declaratory judgment action as to the terms of their leases); Vermont Teddy Bear Co., 1 NY3d 470 (refusing to enforce a notice requirement not stated in the lease); Oppenheimer & Co. v Oppenheim, Appel, Dixon & Co., 86 NY2d 685 (1995) (enforcing conditional precedent to the formation of a sublease); Rowe, 46 NY2d 62 (refusing to enforce an alleged implied covenant against assignment); Fifty States Mgt. Corp. v Pioneer Auto Parks, Inc., 46 NY2d 573 (1979) (enforcing rent acceleration clause).

This Court has also recognized the importance of certainty in the context of agreements that settle disputes. New York courts "have long favored and encouraged" parties to draft agreements "as a means of expediting and simplifying the resolution of disputes" and conserving judicial resources. Mitchell v New York Hosp., 61 NY2d 208, 214 (1984); see Salesian Soc. v Village of Ellenville,

41 NY2d 521, 525-526 (1977). To promote this interest, this Court has "repeatedly held that…parties to a civil dispute are free to chart their own litigation course." Mitchell, 61 NY2d at 214; see T.W. Oil, Inc. v Consolidated Edison Co., 57 NY2d 574, 579-80 (1982).

Freedom of contract, however, is not absolute, nor should it be. As this Court has explained, "[t]here exists an unavoidable tension between the concept of freedom to contract, which has long been basic to our socioeconomic system, and the equally fundamental belief that an enlightened society must to some extent protect its members from the potentially harsh effects of an unchecked free market system." Rowe, 46 NY2d at 68. As a result, "society has chosen to intervene in various ways in the dealings between private parties." Id. Such intervention is illustrated by the rules developed by Legislature and the courts to restrain freedom of contract and guide it in a direction that advances society's interests. To illustrate, the courts will not enforce agreements that violate the law or some strong public policy, as reflected in "the Constitution, statutes or decisions of the courts." New England Mut. Life Ins. Co. v Caruso, 73 NY2d 74, 81 (1989); see Rowe, 46 NY2d at 68. For example, public policy is "set against the imposition of penalties or forfeitures for which there is no statutory authority." Truck Rent-A-Ctr., Inc. v Puritan Farms 2nd, Inc., 41 NY2d 420, 424 (1977). A penalty requires a "payment of a sum of money grossly disproportionate to the amount of actual damages" in

order to "secure performance by the compulsion of the very disproportion." Id. at 424.

But this Court has cautioned that invalidating part of an agreement on public policy grounds deprives one party of the benefit of the bargain, upending the balance struck at the conclusion of the parties' negotiations. Oppenheimer & Co., 86 NY2d at 695; Rowe, 46 NY2d at 67. This Court will not deprive one party of the benefit of the bargain unless the public policy favoring freedom of contract "is overridden by another weighty and countervailing public policy." 159 MP Corp., 2019 NY Slip Op 03526 at *7-8.

B. The Agreement Lacks All The Hallmarks Of A Penalty

1. The Agreement Resolved The Corporation's Breach Of The Lease By Allocating Responsibility To Party In The Best Position To Manage It

Here, the Agreement did not violate the law or public policy. Rather, the Corporation and the University – through counsel – constructed a practical way to resolve the commercial dispute caused by the Corporation's conceded breach of the Lease. Everyone involved in this dispute recognized that the Corporation had breached the Lease and that the University could enforce its rights under the Lease. Those rights included, but were not limited to, the ability to recover past rent, interest, expenses, and future rent.

To settle this dispute proactively, and at the request of the Corporation, the parties retained some of their rights under the Lease and replaced others with a system that allocated risk and responsibility to the party in the best position to bear it. The University bore the risk and potential benefit of re-entering the Premises. If the University failed to re-let the premises, it bore the risk of a vacancy. If the University rented the Premises for less than the Corporation's rent, the University could not seek the deficiency from the Corporation, as provided in the Lease (44). By contrast, the University would receive the benefit of a higher rent from a new tenant, if any. Naturally, the University was in the best position to manage these risks.

The Corporation, in turn, bore the responsibility of making payments according to the agreed-upon schedule. The timeliness of those payments was essential to the agreement because they represented rent that was past due for many months. If the Corporation timely made these payments representing *past* rent, its obligation to pay *future* rent, interest and expenses under the Lease would cease. But if the Corporation refused to make timely payments, the parties agreed to the reverse. The Corporation would be forgiven of *past* rent, interest and expenses but remain responsible for a sum representing *future* rent. In either case, the University would receive an amount equal to at least one of the pre-existing rights that it had bargained for in the Lease.

2. Retaining Pre-Existing Rights From The Lease Is Not A Penalty

This carefully crafted arrangement does not have any of the qualities of a penalty. The purpose of a penalty is to "secure performance." Truck Rent-A-Ctr., 41 NY2d at 424. A penalty achieves this purpose by requiring a "payment of a sum of money grossly disproportionate to the amount of actual damages" arising from the breach. Id. This definition presupposes that the party seeking the penalty did not have pre-existing right to that amount from a previously negotiated agreement.

The case law reflects this fact. In cases finding an unenforceable penalty, one party seeks an arbitrary amount that was unrelated to a bargained-for right that pre-existed the agreement containing the penalty. See City of Rye v Pub. Serv. Mut. Ins. Co., 34 NY2d 470, 472 (1974) (holding that penal bond requiring one party to pay $200 per day for each day that a construction remained uncompleted constituted a penalty); Seidlitz v Auerbach, 230 NY 167 (1920) (holding that requiring a sum of $7,500 for failing to pay one moth of rent, which ranged from $333 to $458, constituted an unenforceable penalty); 555 W. John St., LLC v Westbury Jeep Chrysler Dodge, Inc., 149 AD3d 796, 797 (2d Dept 2017) (holding that lease agreement to store automobiles on a lot required payment of $5,000 per day for each day after the deadline that the defendant remained in possession of the original portion of the lot, *in addition to* any actual damages arising from the

holdover); Del Nero v Colvin, 111 AD3d 1250, 1250 (4th Dept 2013) (finding a penalty where the agreement required, in the event of a breach of a non-compete clause, that all future payments in an agreement requiring monthly payments of $7,000 over a 73–month period would be considered paid in full); Fingerlakes Aquaculture, LLC v Progas Welding Supply, Inc., 34 AD3d 1070, 1071 (3d Dept 2006) (holding that a clause providing for a $400 per day "fine" for nondelivery of a 13,000–gallon tank constituted a penalty); Pyramid Ctrs. and Co. v Kinney Shoe Corp., 244 AD2d 625, 627 (3d Dept 1997) (finding a penalty where a lease stated that upon defendant's breach plaintiffs are entitled to double the fixed rent or the average annual percentage rent, whichever is greater).

No court has ever held that a pre-existing right that was bargained for in a separate agreement can qualify as a penalty. And this Court should not be the first. Instead, the Court should hold that a provision allowing a party to receive an amount equal to the amount due under a pre-existing right does not qualify as a penalty.

3. The Agreement Was Not Designed To Coerce Compliance

Further, this provision was not designed to coerce compliance. To reiterate, this Agreement was entered into at the Corporation's request for the benefit of the Corporation. Thus, it is counterintuitive for anyone to argue that any provision thereof was designed to coerce the Corporation's compliance with the terms of the

Agreement. The Agreement was designed to give the University at least *one* of the rights it bargained for in the Lease. The parties' decision to allow the University to retain one of the rights it already bargained for is not unfair in any way. By receiving an amount representing *future* rent, the University had to forego *past* rent, interest and expenses. The University had already bargained to receive a sum equal to both amounts before the Agreement came into existence.

Moreover, the Corporation – at all times – controlled which pre-existing right the University would enjoy. The Corporation alone controlled whether it would be liable for past rent or an amount equal to future rent, just as the University had control over whether the Premises would be re-let. The Corporation's control over its own destiny is best illustrated by its sudden ability to find a way to pay the full amount of past rent in December 2016 – after the University had already filed a complaint and a motion for summary judgment. The Corporation claims to have secured a loan, but offers no explanation for why it did not do so before missing the first five monthly payments. The Corporation's default and belated payment demonstrate that it weighed the costs and benefits of beaching and complying, just as any sophisticated businessperson would do.

4. The University's Pre-Existing Right Was Not Grossly Disproportionate To The University's Actual Damages

Finally, the Agreement does not contain a penalty because the University's actual damages were neither disproportional to the amount owed under the Agreement, nor capable of being ascertained at the time of entry of the Agreement.

When analyzing whether the University's actual damages were ascertainable, the Court must look at the moment in time when the parties entered into the Agreement. At that time, the parties knew the Corporation had breached the Lease but not how much damage the University would suffer as a result. Against this backdrop, the parties sensibly used the Agreement to compensate the University for the losses resulting from the breach of the Lease under certain circumstances. But the parties had to estimate such losses because they could not predict how long the Premises would be vacant, the unquantifiable effects of such vacancy, the financial inducements and concessions necessary to acquire a new tenant or the amount of rent the new tenant would be willing to pay, and the other fees to be incurred in connection with finding a new tenant. Although the University was in the process of trying to find a new tenant (221), the commercial real estate market in Manhattan is notoriously unpredictable, which is precisely why this Court has promoted contract certainty in commercial real estate

agreements. See Vermont Teddy Bear, 1 NY3d at 475; see also supra at 24-25 and cases cited therein.

Nevertheless, these parties did what sophisticated parties do. They accounted for "an otherwise uncertain future" by putting their agreement in writing to "obtain some measure of security[.]" 159 MP Corp., 2019 NY Slip Op 03526 at *9 (Wilson, J., dissenting). In the midst of this uncertainty, the parties estimated the University's losses to be approximately $1,200,000.

This estimate was ultimately proven to be proportional to the University's actual damages. As a result of the Corporation's default on the Lease, the University suffered losses of $261,000 in past rent (44), $200,000 in brokerage fees (60), $90,000 in attorneys' fees as a result of breaching the Lease (60) and $300,000 in free rent, which the University ultimately was forced to offer to induce the new tenant to take possession (223). These quantifiable damages under the Lease amount to $851,000, but they could have been much greater, if the University had been unable to find a new tenant for an extended period of time. Thus, the parties' estimated loss of $1,200,000 is proportional to the $851,000 in actual damages suffered by the University.

C. If The Court Does Not Hold That The Agreement Is Enforceable As A Matter Of Law, It Must Remand For A Hearing

If the Court does not conclude that the Agreement is enforceable as a matter of law, the Court should modify the Appellate Division order to direct a hearing to determine the University's actual damages and the extent to which those damages were ascertainable at the time of the entry into the Agreement. That is precisely what the Court has previously ordered the lower courts to do. See 172 Van Duzer Realty Corp. v Globe Alumni Student Assistance Association, Inc., 24 NY3d 528, 536 (2014).

In Van Duzer, there was a dispute as to the amount of actual damages and whether such damages were ascertainable at the time of entry into the agreement at issue. 24 NY3d at 536-537. The defendant had requested, but was not permitted, discovery on the plaintiff's actual damages. This Court held that it did not have sufficient evidence from the breaching party of the actual damages incurred by the non-breaching party to make a determination. Id. This Court remanded the case for a hearing to allow the parties to "present evidence that the undiscounted accelerated rent amount is disproportionate to Van Duzer's actual losses, notwithstanding that the landowner had possession, and no obligation to mitigate." Id. at 537.

The same is true here. No discovery has been conducted, and both parties acknowledged that a hearing would be necessary if the courts did not find the Agreement was enforceable as a matter of law (158, 170, 218). Thus, if this Court does not enforce the Agreement as the parties drafted it, the case should be remanded for a hearing to determine the amount of Appellant's actual damages and the extent to which those damages were ascertainable at the time of entry into the Agreement. Because the Agreement is inextricably intertwined with the Lease, the lower courts must consider the University's damages flowing from Corporation's breach of both the Lease and the Agreement.

POINT II

THE APPELLATE DIVISION IMPROPERLY VIEWED THE AGREEMENT IN ISOLATION WITHOUT CONSIDERING ITS CONTEXT

A. The Appellate Division Should Have Considered The Circumstances That Gave Rise To The Agreement

The Appellate Division analyzed the Agreement without considering its context. As a result, the court restricted its analysis to whether the damages from a breach of the Agreement were readily ascertainable. Answering this question in the affirmative, the court reasoned that the University must have been attempting to "secure performance by threat of a large payment" because the Agreement

"would result in an award 7 ½ times the amount that [the University] would have received" if the Corporation had fully performed the Agreement.

The Court's analysis takes into account the amounts due under the Agreement but ignores the meaning behind those amounts. As a consequence, the Court's analysis does not consider that, at the time of execution, the University had already bargained for the right to ultimately receive *both* amounts described in the Agreement because they represented past and future rent under the Lease. By focusing exclusively on the amounts and ignoring what those amounts represent, the Court missed the thrust of the parties' Agreement, which was to allow the University, which had given up many rights under the Lease, to enjoy at least one benefit of its bargain.

The cases cited by the Court further illustrate its restrictive focus on the amounts due, but not their meaning. See Clean Air Options, LLC v Humanscale Corp., 142 AD3d 923, 924 (1st Dept 2016) (involving a late fee with a 78% annual interest rate, which the parties described as a "penalty"); Bui v Indus. Enterprises of Am., Inc., 41 AD3d 238 (1st Dept 2007) (involving a promissory note obligating one party to pay $2,000 for each day it failed to pay the judgment); Sandra's Jewel Box Inc. v 401 Hotel, L.P., 273 AD2d 1, 3 (1st Dept 2000) (involving a late charge provision of a lease awarding a 365% per annum penalty). None of these cases involve a party seeking to enforce a right that existed *before* the formation of the

agreement containing the penalty. Every one of these cases involves an arbitrary amount charged as a late fee to coerce compliance. The Agreement here does not contain an arbitrary amount. Both sums represent one of the rights the University bargained to acquire in the Lease and bargained to retain in the Agreement. Instead of conducting a rote-level comparison of the two amounts potentially owed under the Agreement, the Appellate Division should have considered what the two amounts represented to the parties and the context in which the Agreement arose.

B. The Agreement Does Not Require The Corporation To Pay 7 ½ Times The University's Actual Damages

By not considering the context of the Agreement, the Appellate Division limited its analysis to the damages arising from the Corporation's breach of the Agreement. This restrictive analysis led the Court to conclude that the Agreement required the Corporation to pay 7 ½ times the University's actual damages from the default of the Agreement. The analysis ignored the damages flowing from the Corporation's breach of the Lease, which was the driving force behind the formation of the Agreement in the first place. The Appellate Division should not have divorced the words of the Agreement from the context that gave birth to them in the first place. See Aron v Gillman, 309 NY 157, 163 (1955) (holding that "in construing the provisions of a contract we should give due consideration to the circumstances surrounding its execution"). Moreover, the Agreement acknowledged the existence of the Lease (105), incorporated defined terms from it

(105), and referenced several specific provisions from the Lease (106). The Agreement and the Lease are inextricably intertwined, and the Appellate Division should not have treated them otherwise.

As a result of this error, the Appellate Division affirmed the order directing entry of a judgment against the Corporation for $175,751.73 – the amount the Corporation would have to pay to fully comply with the Agreement. This decision implicitly concludes that the parties could not use the Agreement to account for the damages caused by the Corporation's breach of the Lease. The Appellate Division did not offer any justification for this assumption, and none exists. At the time of the Agreement, the parties knew that the Corporation had defaulted but not how much the University would suffer as a consequence. In light of this uncertainty, these sophisticated parties, through counsel, had every right to use the Agreement to compensate the University, under certain circumstances, for the future harm that might occur from the Corporation's breach of the Lease. Without that assurance, the University would not have entered into the Agreement at all.

When viewed in that context, the Agreement contained a valid liquidated damages clause, not an unenforceable penalty. The Appellate Division should have should honored that Agreement by enforcing it as these sophisticated parties, through counsel, drafted it to settle their dispute over a commercial real estate transaction.

C. The Appellate Division Decision Will Disrupt The Commercial Real Estate Industry Without Producing Any Discernable Benefit

Failure to enforce the Agreement would deprive the University of a benefit it twice bargained for without serving any useful purpose for the parties or producing any societal benefit. Finding an unenforceable penalty would work an injustice by allowing the Corporation to breach the Lease and the Agreement while still retaining the benefits of both. And it would produce a perverse chilling effect on the commercial real estate industry in New York. If the Corporation can breach two agreements with impunity, commercial landlords will have no incentive to avoid litigation proactively by compromising with struggling commercial tenants, as the University did here, because sophisticated commercial tenants, like the Corporation here, will have everything to gain and nothing to lose by breaching.

The Corporation's actions illustrate this danger. The Corporation breached the Lease and secured a potentially favorable agreement to avoid litigation in exchange for an installment plan to pay rent that was already owed. After leaving the University to bear the risk of a vacancy, the Corporation's only obligation was to pay what it already owed in a timely fashion. Almost immediately, the Corporation refused to do so, leaving the University to make a cost benefit analysis about pursuing the past rent.

Not enforcing the Agreement as written under these circumstances would put the Corporation in a luxurious position. If the University walked away from the missed payments, the Corporation would receive a windfall. If the University sought to recover the missed payments, the Corporation could pay what it already owed, leaving itself no worse off than it was before the breach. After conducting its own cost-benefit analysis, the Corporation did just that. And any sophisticated businessperson would do the same. In fact, when a party has other debts that carry a greater consequence for nonpayment, it would be unreasonable for that party *not* to take advantage of such circumstances.

The law should not allow such exploitation by a sophisticated party, and for good reason. "Agreements negotiated at arm's length by sophisticated counseled parties are generally enforced according to their plain language pursuant to [New York's] strong public policy favoring freedom of contract." 159 MP Corp., 2019 NY Slip Op 03526 at *1.

CONCLUSION

Accordingly, because the Agreement did not contain a penalty, this Court should (1) reverse the order of the Appellate Division, First Department; (2) grant the University's motion for summary judgment on the complaint; (3) deny the cross motion of defendant D'Agostino Supermarkets, Inc. ("Corporation") for (a) summary judgment striking the University's claim for liquidated damages and (b)

for entry of judgment against itself for $175,751.73, with interest accrued from October 14, 2016 to the date of the judgment; (4) remand the matter so that the parties can proceed to an inquest to determine the exact amount due under the second and third cause of action; and (5) grant the University any other relief the Court deems appropriate.

In the alternative, if the Court concludes that the Agreement is not enforceable as a matter of law, the Court should remand for a hearing to determine the amount of the University's actual damages from the breach of the Lease and the Agreement and the extent to which those damages were ascertainable at the time of the Agreement.

Dated: New York, New York
August 8, 2019

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