

# MARKS & WEINBERG, P.C.

## **In re Montgomery Ward Holding Corp.**

326 F.3d 383 (3rd Cir. Apr. 24, 2003)

This case serves as another reminder that liquidated damages provisions must only compensate lessors for the loss of their bargain and cannot result in a windfall.

Meridian Leasing Corporation ("Meridian") purchased new computer equipment for approximately six million dollars and leased it to Lechmere, Inc. ("Lechmere") under a true lease pursuant to which the monthly payments totaled less than four million seven hundred thousand dollars. Meridian offered a low rental rate to obtain Lechmere's business in a competitive market, gambling that Lechmere would renew the lease at a rate which would have allowed Meridian to realize a substantial profit over the course of the renewal term. Unfortunately for Meridian, the gamble did not pay off. Montgomery Ward and its affiliates, including Lechmere, declared bankruptcy with ten months still left on the lease. Lechmere rejected the lease contract pursuant to its statutory rights under §365 of the Bankruptcy Code and Meridian sued for damages under the liquidated damages provision in the lease.

The liquidated damages provision provided that, in case of breach, Lechmere would pay Meridian a sum equal to the "Casualty Value" of the equipment. As is common in the industry, the Casualty Value was provided by way of a spreadsheet attached to the lease. Although the lease contained standard language that the Casualty Value would be paid as liquidated damages for loss of a bargain and not as a penalty, the Court noted that "the tyranny of labels does not extend to the terms that are attached by parties to a contract [and



that a] determination of whether a contractual provision for damages is a valid liquidated damages provision or a penalty clause is a question of law for the court." The court then analyzed the provision in the lease to determine if it placed Meridian "in a position legally superior to the one that it would have occupied had the lease been fully performed."

At the time Lechmere defaulted on the lease, the Casualty Value of the equipment was three and one-half million dollars but Lechmere owed only one and one-half million in rent through the remainder of the term. Thus, Lechmere actually owed Meridian two million dollars more in liquidated damages than it would have owed had it paid everything due Meridian under the lease and chosen to return the equipment instead of purchasing it or renewing the lease. Of course, Meridian had designed the liquidated damages clause so that it would recover the profit it had hoped it would realize upon a renewal of the contract.

The court held that Meridian could not seek, as liquidated damages, profits that it wasn't guaranteed under the actual contract. Rather, Meridian was only entitled to the sum of the present value of the future rentals to the end of the lease plus the present value of the Meridian's remainder interest in the computers at the end of the lease in the event Lechmere elected to return the equipment. Since the computer equipment was worth substantially less than the two million plus dollars projected by the liquidated damages provision, the court struck down the provision as an unenforceable penalty.

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