

## REAL ESTATE CLIENT ALERT

### Liquidated damage clause permitting full rent acceleration deemed valid when commercial tenant defaults

On July 17, 2007, the Massachusetts Supreme Judicial Court, in *Cummings Properties, LLC v. National Communications Corp.*, ruled that a liquidated damages clause in a commercial lease providing for full acceleration of future rent upon tenant's default is enforceable. This ruling substantially modified a sixty-five-year-old precedent that had effectively prohibited such clauses. Despite the Court's ruling, we do not recommend that commercial landlords include full acceleration clauses in lease agreements at this time, as their long-term enforceability remains uncertain.

Commercial leases in Massachusetts typically feature one of two common provisions requiring a tenant to continue to pay rent after the lease is terminated due to a tenant default. In one provision, tenant is required to pay rent monthly, according to the schedule set forth in the lease, for the remainder of the term as though the lease had not been terminated. However, the amount actually paid will be net of amounts received by landlord from reletting the premises (after landlord deducts the unreimbursed costs of reletting).

In an alternative provision, landlord has the option to require tenant to pay, as liquidated damages, a lump sum equal to the amount by which the aggregate rent due for the remaining lease term exceeds the current fair market rent for the premises for the remainder of the term. The amount is then discounted to present value.

The alternative provision is typically referred to as a "partial acceleration" clause which is intended to give landlord the benefit of its bargain. If the lease rent for the remainder of the term is greater than the fair market rent, landlord under this formula receives the difference, thus giving landlord the benefit lost as a result of tenant's default. If the fair market rent is more than the lease rent, landlord would receive nothing under this partial acceleration.

This partial acceleration clause comports with the contract law notion of mitigation of damages: even where a landlord is entitled to damages resulting from a tenant's default, landlord must moderate those damages as noted above, either by re-letting the premises or by calculating damages by reference to the current market rate (a simulated re-letting), where the lease contract rate is higher than market rate.

In contrast, if a landlord is permitted to fully accelerate rent due under a lease without being required to mitigate damages, the result is closer to a penalty insofar as the damages received may very likely be disproportionate to the damages actually incurred. For this reason, full acceleration clauses have not been enforceable in Massachusetts since the 1942 decision of the Supreme Judicial Court in *Commissioner of Insurance v. Massachusetts Accident Co.*

The Court in *Cummings* explained its departure from the established rule as correlating to a "unanimous" trend towards enforcing liquidated damages clauses in contracts between commercial parties and suggested that the use of such clauses would help to streamline the process of calculating damages under a lease, thereby "eliminat[ing] uncertainty and costly litigation." However, a full acceleration of future rent as liquidated damages is such a departure from the partial acceleration clause which is typical in most commercial leases in Massachusetts that it is likely to invite future litigation.

The Court has previously upheld liquidated damage clauses under purchase and sale agreements in its 1999 case of *Kelly v. Marx* by holding that a seller was entitled to retain a defaulting buyer's 5% deposit, but indicated that it was doing so because the typical deposit under such agreements ranges between 5% and 10% of the purchase price. By analogy, the use of a full acceleration clause as liquidated damages under a lease would be similar to a seller insisting on a 50% deposit under its purchase and sale agreement and then retaining the deposit as liquidated damages.

In the *Marx* case, the Court stated that the liquidated damages of 5% was not grossly disproportionate to the expected damages nor was it unconscionably excessive so as to be defeated as a matter of public policy. In fact, the Court warned in that case that "we reiterate our view that '[a] term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.'"

In light of that warning and the requirement that a landlord is required to mitigate damages when a tenant defaults under its lease, we recommend that landlords not rush to include full acceleration clauses in commercial leases, but instead should continue with the customary practice of using partial acceleration clauses as a measure of liquidated damages.

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