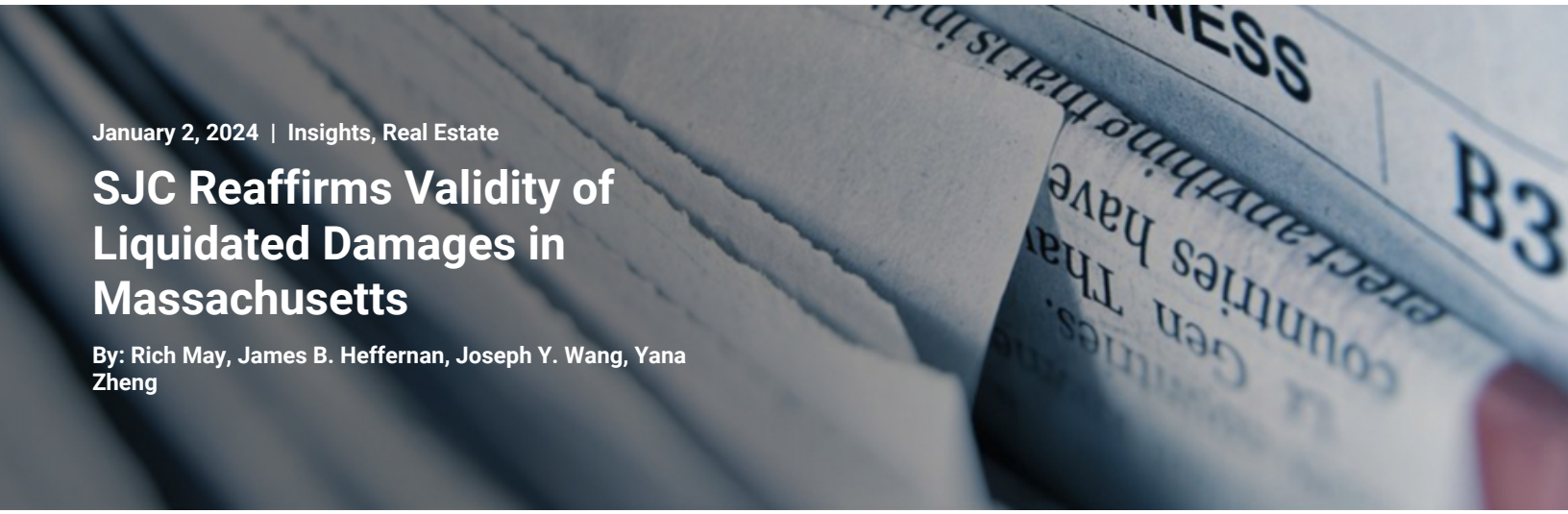

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SJC Reaffirms Validity of Liquidated Damages in Massachusetts

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In a recently decided case, *Cummings Properties, LLC v. Hines*, the Massachusetts Supreme Judicial Court (SJC) upheld its fundamental deference to parties' freedom to contract with respect to damages. In its ruling, the SJC embraces the autonomy of parties to negotiate and determine remedies that best suit their circumstances by enforcing a liquidated damage clause as agreed by the parties at the time of the formation of a lease.

What are Liquidated Damages?

In contract law, liquidated damages serve as a way to preemptively agree on damages in the event of a future breach of contract in lieu of attempting to ascertain damages which would be difficult to quantify (particularly after such a breach, when tensions are running high and cooperation is unlikely). These are often utilized in real estate leases, where the benefit of a landlord's bargain of the rental stream over the lease term is relatively easy to quantify in comparison to an in-the-moment calculation of fair market rent at the time of breach. Of course, where the liquidated damages diverge too far from anticipated damages, the agreed-upon damages begin to look more punitive than restorative. The SJC has long held that liquidated damages specified by parties in a contract should be enforced as long as they are "not so disproportionate to anticipated damages as to constitute a penalty."

Ruling in Cummings Properties, LLC v. Hines

In determining whether a liquidated damages provision is unfairly punitive, courts have wrestled with whether to review the contract only at the time of its creation (called a "single look" approach) or to review the circumstances once the breach has occurred (the "second look" approach). In *Cummings*, the central question was whether a landlord could claim as liquidated damages the accelerated rent (*i.e.*, the entire rental stream for the remainder of the term as bargained under the lease) even after it had entered into a new lease for the property with another tenant. Notwithstanding the SJC's previous adoption of the "single look" approach (see *Kelly v. Marx*, 428 Mass. 877 (1999)), the Massachusetts Appeals Court utilized the "second look" method and determined that the liquidated

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damages, because they did not take into account the substitute rent from the replacement tenant, were unfairly punitive and unenforceable. For more details on the appellate court's treatment of the question, please see our prior blog post.

However, on further appeal, the SJC affirmed its "single look" approach, explaining that it most accurately matches the expectations of the parties in the event of a breach. The SJC also considered that the "single look" approach preserves a contract's potential to promote certainty, resolve disputes efficiently and avoid litigation, and cited the autonomy of the parties to negotiate "a liquidated damage amount that was fair to each side based on their unique concerns and circumstances surrounding the agreement, and their individual estimate of damages in event of a breach."

The SJC also speculated that the "second look" approach would spur more legal disputes in contravention of the whole point of a liquidated damages clause, since an aggrieved party would be encouraged to have a court factor in the circumstances of the time of the breach in considering the punitive nature of liquidated damages.

For parties attempting to challenge a liquidated damages clause, in addition to arguing that the liquidated damages were not a reasonable forecast of damages at the time the contract was entered, the SJC expressly left open a second argument. In order for a liquidated damages clause to be entitled to a presumption of validity, the party against whom it is used must have been "sufficiently sophisticated" to have understood the implications of the provision. If a party can demonstrate that she was not sufficiently sophisticated, she may be able to avoid a liquidated damages provision even under the "single-look" approach. However, in this case, the tenant was determined to be "sufficiently sophisticated." In an arms-length, commercial lease, this second argument is a high bar.

One cautionary lesson remains the same between the appellate court and the SJC's treatment of the *Cummings* lease. If the lease does not require the mitigation of accelerated rent by replacement lease proceeds, the courts will not step in to save the defaulting tenant by finding the liquidated damages punitive. This is consistent with the SJC's deference to the freedom of parties to negotiate their own contracts, even to their ultimate detriment.

Disclaimer: This summary is provided for educational and informational purposes only and is not legal advice. If you have any questions concerning liquidated damages, leases, or landlord-tenant disputes, please don't hesitate to reach out James Heffernan, Joseph Wang, or Yana Zheng.

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