ALERT: Court Finds That Landlord May Not Seek Damages For Breach of Commercial Lease Until Lease Period Expires

By Michael J. Rossi

A recent decision by the state Appeals Court affirms a harsh reality for commercial landlords: under Massachusetts law, a landlord may not recover damages under the indemnity clause of a lease until the term of the lease has ended.

Practically, this means that in cases where a tenant defaults in the early stages of a long-term lease, a landlord may have to wait years before collecting unpaid future rent.

Such a predicament can be avoided. A landlord can be protected by incorporating certain provisions in its commercial leases, such as a liquidated damages provision, to accelerate the payment of damages in the event of a breach.

Appeals Court Ruling

In the recent Appeals Court case, a dental practice entered into a 12-year lease for commercial space in downtown Boston beginning in April, 2006. Just over a year later, the dental practice closed and the tenant notified the landlord that no further rent payments would be made. The landlord re-entered, took possession of the premises and filed suit against the tenant. The landlord sought to collect as monetary damages the difference between the rent it would have collected from the dental practice over the full term of the lease and the rent a new tenant was going to pay over the same time period (a lesser amount). Though a lower court judge found in favor of the landlord, the Appeals Court overturned the ruling, finding that the lawsuit was premature. (The landlord's request for review of this decision by the state Supreme Judicial Court is pending).

The Appeals Court concluded that under Massachusetts law, a landlord must wait to collect damages until the end of the original lease term. The reasoning underlying this legal principle is that the full amount of rent which the tenant would eventually pay cannot be fully ascertained until the period ends. For example, what if a fire should damage the premises? What if the property is taken by eminent domain? Where a tenant's responsibility to pay rent is ultimately contingent upon events that could happen in the future, the rule in Massachusetts is that a landlord must wait until the end of the lease term to definitively calculate its damages for loss of rent.

Planning Ahead

Fortunately for landlords, the consequences of this rule can be avoided. The law has long recognized the freedom to contract and, not surprisingly, many commercial leases now include rent acceleration or liquidated damages clauses that permit the landlord to seek damages for potential lost income *before* the end of the original lease term in the event of a breach by a tenant.

The problem for the landlords in the recent Appeals Court case was that the lease included a standard indemnity clause, but nothing more. An indemnity clause simply obligates a defaulting tenant to reimburse the landlord for any actual losses once those losses can be readily ascertained, *i.e.* at the end of the lease term. A carefully drafted rent acceleration clause, on the other hand, could require a tenant to pay the landlord the entire amount of the remaining rent due under the lease at the time of default. Likewise, a liquidated damages provision sets forth a specific amount of damages a tenant would owe in the event of a breach. These types of lease provisions have been upheld by Massachusetts courts as enforceable so long as they are not so disproportionate to the anticipated, actual damages as to constitute a penalty.

In light of the recent Appeals Court ruling, and the prospect of having to wait years to collect lost rent from tenants, commercial landlords would be well-advised to review their leases with counsel to ensure that they are protected in the event of a default.

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