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Landlord's damages delayed for six years

by Eric T. Berkman

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A commercial landlord whose tenant broke a 12-year lease after only 24 months could not seek damages until the expiration of the entire lease term, the Appeals Court has decided.

A Superior Court judge had ruled that the landlord could immediately collect the difference between the rent that it would have received over the term of the original lease and what it would receive under a lease it subsequently signed with a replacement tenant. The judge's reasoning was that the traditional bar to recovery, under an indemnity provision, until the original lease expires does not apply when a landlord re-leases the premises.

But the Appeals Court reversed.

"We are cognizant of the concerns raised by [the] long-established rule … given the possible intervention of factors, presently unknown, that make the determination of damages uncertain at the present," Judge Francis R. Fecteau wrote for the court. "However, given the present state of the law and the specific terms of the contract to which parties of equal bargaining power agreed, we are constrained … to deny recovery to the landlord under the indemnification clause of this lease."

The 17-page decision is *275 Washington Street Corp. v. Hudson River International, LLC, et al.,* Lawyers Weekly No. 11-038-12. The full text of the ruling can be found by clicking here.

Benefit of the bargain

Bruce E. Falby of DLA Piper in Boston, who represented the defendant tenant, said the Appeals Court simply applied "settled law" that limits a landlord's options, after the breach of a lease, to those remedies that are spelled out in the lease.

"As the court noted, parties of equal bargaining power made a deal under established law, and our client is entitled to the benefit of that bargain," he said.

Falby added that the landlord could have protected itself by insisting on the kind of lease provisions, such as a liquidated-damages clause, that it included in its subsequent lease with the replacement tenant.

David G. Hanrahan of Gilman, McLaughlin & Hanrahan in Boston was counsel for the plaintiff landlord. He said his client is deciding whether to seek further appellate review, noting that in a concurring opinion, Judge R. Marc Kantrowitz suggested that it do so.

"His suggestion is well-founded in light of changes in commercial realities between now and when the theory [applied by the court] began," he said.

Hanrahan said in rejecting his argument that his client was still entitled to damages under a "cumulative remedies" clause included in the lease, the court may have construed the clause too narrowly.

"The plain language of the cumulative remedies clause does suggest that any remedies contained in the actual lease were not exclusive," he said. "[Such language] suggests you can go outside the lease and into basic contract law, which would permit a 'benefit of the bargain' theory of damages. So we're reviewing the decision carefully."

Framingham lawyer Michael G. Gatlin, vice chairman of the Massachusetts Bar Association's Property Law Section Council, called the ruling "a hard decision in terms of the result," but "correct in its reasoning."

Gatlin, who was not involved in the case, said the ruling would apply only to a small number of tenant

default situations, since most tenants default due to insolvency.

"So whether you assess damages now or six years from now, they're usually not around," he said.

But in light of the Appeals Court's ruling, Gatlin said, commercial property owners who are spending significant amounts of money on build-outs to accommodate the needs of new tenants should be sure to put language in their leases that capture the value of the build-outs at the time of a default.

"That way, if your tenant defaults after, say, 18 months and you have to rip out what you put in to accommodate another tenant, such language would allow you to recapture the cost of the build-out," he said.

Joseph R. Torpy, who practices commercial leasing law at Brennan, Dain, Le Ray, Wiest, Torpy & Garner in Boston, said it is unusual in sophisticated commercial leases for the landlord to be protected only by an indemnity provision.

But Torpy said he could still see the issue show up when large national retailers rent space.

"A lot of national retail tenants dictate their lease form, and, as you might expect, those initial drafts are light on remedies, rarely include acceleration provisions, and may expressly state there's no acceleration right," he said. "In such cases, there might be landlords' counsel who say, 'Well, there's an indemnity provision, so I'm OK.' But they might have to [negotiate] more in the way of default protections in such leases in light of this decision."

Broken lease

Plaintiff 275 Washington Street Corp., a commercial landlord, entered a 12-year lease with defendant Hudson River International in April 2006.

The premises were to be used for a dental practice, and the defendant was to pay $16,000 a month with incremental increases annually.

The lease contained a standard indemnification provision requiring the tenant, in the event of a default, to "indemnify" the landlord against any losses such termination might cause "during the remainder of the term." It also had a cumulative remedies clause stating that no other remedies noted in the lease were exclusive.

In May 2007, the dental practice closed. By April 2008, all payments had ceased, and on May 19, 2008, the landlord re-entered and took possession of the premises, terminating the lease agreement.

The landlord subsequently filed a breach-of-contract claim in Superior Court, seeking immediate compensation for unpaid rent and any other damages resulting from the breach.

On March 26, 2010, while the case was pending, the landlord entered a 10-year lease with a replacement tenant. The new lease extended beyond the term of the original one but for lower rent.

A month later, Superior Court Judge Charles T. Spurlock ruled on summary judgment that the defendant tenant was immediately liable for rent and costs owed as of the date of termination as well as loss of future rents and costs under the indemnification clause.

Though Spurlock recognized that the law of the commonwealth typically does not permit a landlord to recover losses under an indemnity provision until the original lease has expired, he found an exception in cases in which the landlord re-lets the property to someone else.

The tenant appealed.

Longstanding rule

The Appeals Court said that indemnity clauses like the one in the case before it do not provide for liquidated damages or any right at all to damages based on a breach of covenant to pay rent.

"Instead, once the period specified for indemnification ends, an indemnity clause obligates a defaulting tenant to reimburse a landlord for any actual losses," Fecteau said.

That means there can be no recovery under an indemnity provision until the lease term has ended, the judge continued, explaining that such a rule "contemplates contingencies such as a taking of the property by eminent domain, destruction by fire or … other events that would serve to terminate the lease as a matter of law or contract, and that support the rationale for delaying an assessment of damages until the end of the lease period."

Meanwhile, the court distinguished the 1905 Supreme Judicial Court decision *Woodbury v. Sparrell Print*, which the Superior Court had relied on to support an exception in which the landlord re-leases the premises to another tenant to be misplaced.

In that case, the lease specifically held the tenant liable for loss or damage stemming from either the premises remaining un-leased or for being leased at lower rent for the remainder of the term.

The indemnification provision in the case before the Appeals Court did not articulate a separate indemnification period for the purposes of determining damages for "the length of time, if any, that the premises remain vacant," Fecteau said.

When a lease provides for no specific obligation on the tenant's part to pay damages directly resulting from the premises remaining un-let, he added, "we conclude that the indemnification period has not terminated. Put another way, where the indemnification period provided for in the lease, during which any damages may accrue, has not yet ended, damages cannot be properly assessed."

At the same time, the court acknowledged the difficulties that the rule barring recovery until the end of the original lease could create.

"We … recognize the possibility that this rule, which forces this landlord to wait until 2018 to determine posttermination damages, may in effect make it impossible for the landlord to recover its true damages … because of the protections afforded by legal processes, such as dissolution or bankruptcy," Fecteau said.

Nonetheless, the Appeals Court concluded, the current state of the law and the contractual terms require that recovery be denied under the indemnification clause.

Eric T. Berkman, an attorney and formerly a reporter for Massachusetts Lawyers Weekly, is a freelance writer.

CASE: *275 Washington Street Corp. v. Hudson River International, LLC, et al.,* Lawyers Weekly No. 11-038-12

COURT: Appeals Court

ISSUE: Does a commercial landlord whose tenant broke a 12-year lease after only two years have to wait until the lease term expires before seeking damages under a standard indemnity provision?

DECISION: Yes, because the damages are unascertainable until the end of the lease term, even when the landlord subsequently signs a new tenant to a replacement lease that extends beyond the term of the original lease

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