

## Liquidated Damages in the Commonwealth of Massachusetts

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### Overview

This article discusses the enforceability of liquidated damages clauses in Massachusetts, particularly in the context of real estate purchase and sale agreements. It is part of a multi-state review of this topic undertaken by ACREL's Acquisitions Committee.

Under Massachusetts law, there is a presumption of the enforceability of liquidated damages provisions in agreements involving sophisticated commercial enterprises.<sup>2</sup> The burden of establishing that a liquidated damages provision is unenforceable rests with the party challenging enforcement of the provision.<sup>3</sup> A party can meet this burden by showing either: (i) that at the time the contract was executed, the actual damages that would be caused by a breach of the contract were not difficult to ascertain, or (ii) that the sum agreed upon as liquidated damages did not, at the time that the contract was executed, represent a reasonable forecast of damages expected to occur in the event of a breach, and instead, operated as a penalty.<sup>4</sup> To determine whether a liquidated damages provision was reasonable, Massachusetts courts look at the circumstances at the time of contract formation, not the actual damages accruing upon a breach.<sup>5</sup> Thus, Massachusetts courts have rejected the "second look" approach where damages clauses are re-evaluated in light of later circumstances, even in cases in which no actual damages were incurred and the non-breaching party would receive a windfall as the result of enforcement of the liquidated damages provision.<sup>6</sup>

In the context of commercial real estate transactions, Massachusetts courts have held that a 5% liquidated damages clause is reasonable as a matter of law.<sup>7</sup> Other acceptable liquidated damages provisions have ranged from 2% to 20% of the total purchase price, depending on the reasonableness of the amount at the time of contract formation and the difficulty of assessing actual damages.<sup>8</sup>

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<sup>1</sup> The authors wish to thank Kelsey Dias Tavares from Harvard Law School who performed the primary research for this article and Shannon Galvin from Boston College Law School who updated the research prior to publication. All accolades belong to Kelsey and Shannon and all mistakes reside with John and Barbara.

<sup>2</sup> See *Guerin v. Stacy*, 56 N.E. 892 (Mass. 1900) (stating that "when parties say a sum is payable as liquidated damages, in general, they will be taken to mean what they say and will be held to their word"). See also, *Bose Corp. v. Ejaz*, 732 F.3d 17, 24–26 (1st Cir. 2013).

<sup>3</sup> See *Cummings Props., LLC v. Nat'l Comm. Corp.*, 869 N.E.2d 617, 622 (2007)

<sup>4</sup> *Id.*

<sup>5</sup> See *Kelly v. Marx*, 705 N.E.2d 1114, 1117–1118 (Mass. 1999). See also, *NPS, LLC v. Minihane*, 886 N.E.2d 670 (Mass. 2008).

<sup>6</sup> See *Id.*; *Perroncello v. Donahue*, 859 N.E.2d 827, 832 (Mass. 2007); *NRT New England, Inc. v. Moncure*, 937 N.E.2d 999, 1003 (Mass. 2010).

<sup>7</sup> See *Kelly*, 705 N.E.2d at 1117; *NRT New England*, 937 N.E.2d at 1003 (stating that a liquidated damages clause in a real estate purchase and sale agreement permitting seller to retain a deposit of 5% of the purchase price for buyer's default was reasonable and enforceable as a matter of law).

<sup>8</sup> See *Kunelius v. Town of Stow*, 588 F.3d 1 (1st Cir. 2009). See also, *Edlow v. RBW, LLC*, 688 F.3d 26 (1st Cir. 2012)

**1. Are liquidated damages an exclusive remedy or may the Seller also seek specific performance?**

Absent clear evidence of the intention of the parties to the contrary, under Massachusetts law, the mere existence of a liquidated damages provision does not necessarily prevent an action for specific performance. “Liquidated damages clauses do not preclude other remedies available at law or equity under Massachusetts law, absent clear intention of parties to the contrary.”<sup>9</sup> It is the parties' intention, as expressed through the terms of the contract, that is controlling in determining whether liquidated damages provisions preclude other remedies.<sup>10</sup> For example, courts have held that claims for specific performance and for statutory damages are not precluded on grounds that the liquidated damages clause provides an exclusive remedy unless the liquidated damages provision includes a statement evincing a clear intent to waive all other remedies.<sup>11</sup> “Where the intent of the parties is that the liquidated damages provision is security for the performance of the contract rather than an alternative to performance, specific performance is not barred.”<sup>12</sup>

**2. May the parties create an enforceable option for the Seller to pursue either liquidated damages or actual damages?**

The answer to this question is unclear. In a 2013 lease termination case, the Massachusetts Superior Court, recognizing that Massachusetts courts had not spoken definitively on the issue, looked to other jurisdictions and, similar to Florida, Illinois, and New York, held that “the existence of an option to sue for actual damages has the effect of turning a liquidated damages provision into an unenforceable penalty provision.”<sup>13</sup> However, in that case, the amount of the liquidated damages at the time the remedy was elected was disproportionate to the actual damages suffered by the non-breaching party.<sup>14</sup> Other Massachusetts courts have held that parties may create an enforceable option to pursue either liquidated damages or actual damages.<sup>15</sup> These courts have expressed that although a contractual option can't be used as a cover for the enforcement of a penalty, if it was intended to give a real option...the contract may be enforced.”<sup>16</sup>

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<sup>9</sup> See *North Am. Consol., Inc. v. Kopka*, 644 F.Supp. 191, 193 (D. Mass. 1986); *De Blois v. Boylston & Tremont Corp.*, 183 N.E. 823 (Mass. 1933).

<sup>10</sup> See *North Am.*, 644 F.Supp. at 193.

<sup>11</sup> *Id.*

<sup>12</sup> See *De Blois*, 183 N.E. 823; [Rigs v. Sokol, 61 N.E.2d 538 \(Mass. 1945\)](#); *Novelty Bias Binding Co. v. Shevrin*, 175 N.E.2d 374 (Mass. 1961).

<sup>13</sup> *Zuckerman v. Vanu, Inc.*, 2013 WL 1799859 (Mass. Super. Ct. 2013).

<sup>14</sup> *Id.*

<sup>15</sup> See *Kulakowski v. Leavitt*, 1996 Mass.App.Div. 159 (Mass. Dist. Ct. 1996) (holding that a contract in which the seller had the option of accepting liquidated damages, the difference between the purchase and sale agreement price and fair market value, or the actual out of pocket losses, was valid). See also, *Schrenko v. Regnante*, 537 N.E.2d 1261 (Mass. App. Ct. 1989) (stating that the contract at issue gave the seller the right to consider the damages unliquidated and to seek additional damages beyond the amount of the forfeited in the deposit) and *North Am.*, 644 F.Supp. at 193 (stating that liquidated damages clauses do not preclude other remedies available at law or equity).

<sup>16</sup> See *Blay v. Zipcar*, 718 F. Supp. 2d 115 (Mass. Dist. Ct., 2010); *Avery v. Hughes*, 611 F.3d 690 (1st Cir. 2011).

**3. *If the contract creates an option between liquidated damages and actual damages, may the Seller elect both?***

The Seller may not elect both remedies unless the contract expressly permits it. When a party elects to retain a deposit as liquidated damages, that party cannot in addition seek actual damages.<sup>17</sup> “The law of contracts is intended to give an injured party the benefit of the bargain, not the benefit of the bargain and a windfall.”<sup>18</sup> Courts have held that “liquidated damages and actual damages are, absent express language permitting recovery of both, mutually exclusive remedies, [so] that where an election is permitted, the election of one remedy bars pursuit of the other.”<sup>19</sup>

**4. *If the Seller may decide between liquidated damages and actual damages, but not both, when must it decide?***

If the contract allows the Seller to elect liquidated damages or actual damages (but not both), then under Massachusetts law, the Seller would likely have to make that election before or at the time of a default.<sup>20</sup>

**5. *Does Massachusetts have a statute addressing liquidated damages?***

There is no statute specifically addressing liquidated damages in this context.

**6. *What is the test for a valid liquidated damages clause?***

Under Massachusetts law, a clearly written liquidated damages provision will usually be enforced provided that: (i) at the time the contract was signed, the actual damages that would result from a breach were difficult to ascertain, and (ii) the sum agreed upon as liquidated damages represents a reasonable forecast of damages anticipated to result from a breach.<sup>21</sup> Massachusetts courts have recognized that “actual damages in real estate transactions are particularly hard to ascertain at the time a contract is entered into because it is hard to predict when and for what price a property will resell if the deal falls through.”<sup>22</sup> Thus, liquidated damages provisions are particularly appropriate in real estate purchase and sale agreements.<sup>23</sup>

**7. *Who has the burden of proof?***

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<sup>17</sup> See *SMS Financial V, LLC v. Conti*, 865 N.E.2d 1142 (Mass. App. Ct., 2007) (holding that a liquidated damages provision “calling for a double recovery” is an unenforceable penalty).

<sup>18</sup> *Perroncello v. Donahue*, 859 N.E.2d 827 (Mass. 2007).

<sup>19</sup> *Avery v. Hughes*, 661 F.3d 690 (1st Cir. 2011) (citing *Orr v. Goodwin*, 953 A.2d 1190, 1196 (2008)).

<sup>20</sup> See *Zuckerman v. Vanu, Inc.*, 2013 WL 1799859 (Mass. Super. Ct. 2013) (holding that an option must be exercised at or about the same time the breach occurs, and that where a breach occurs long before a seller decides among contractual remedies, it is unenforceable).

<sup>21</sup> *Cummings Props.*, 869 N.E.2d at 622; *TAL Financial Corp.*, 844 N.E.2d 1085.

<sup>22</sup> See *Kelly*, 705 N.E.2d.

<sup>23</sup> *Id.* at 881-82; *NRT New England, Inc. v. Moncure*, 937 N.E.2d 999, 1003 (Mass. 2010).

Under Massachusetts law, the burden of proof regarding enforceability of liquidated damages clauses rests on the party seeking to set the liquidated damages provision aside.<sup>24</sup> To be successful, the challenging party must establish that the amount of liquidated damages is unreasonably and grossly disproportionate to the actual damages from a breach or unconscionably excessive.<sup>25</sup> Any reasonable doubt as to whether a provision constitutes a valid liquidated damages clause is to be resolved in favor of the aggrieved party.<sup>26</sup>

#### **8. *As of when is reasonableness tested?***

Massachusetts courts have adopted the “single look” approach to the enforceability of liquidated damages clauses.<sup>27</sup> In determining whether the sum agreed upon represents a reasonable estimate of the anticipated or actual damages, the court examines only the circumstances at the time of contract formation, regardless of what actual damages may have accrued at the time of the breach.<sup>28</sup> Thus, where liquidated damages clauses are concerned, Massachusetts courts reject the “second look” approach where the clause is re-evaluated in light of later circumstances.<sup>29</sup> Although there is no bright line separating an agreement to pay a reasonable measure of damages from an unenforceable penalty clause, the greater the difficulty either of proving that loss has occurred or of establishing its amount with requisite certainty, the easier it is to show that the amount fixed as liquidated damages is reasonable.<sup>30</sup>

#### **9. *What percentage of the purchase price is likely acceptable for liquidated damages?***

In terms of a percentage that safely falls within reasonable limits, Massachusetts courts have held that “5% of the purchase price in a contract for the purchase and sale of real estate is reasonable as a matter of law.”<sup>31</sup> While sellers have challenged liquidated damages of a smaller percentage of the purchase price as being too small, those liquidated damages clauses have been enforced.<sup>32</sup> Massachusetts courts have also allowed liquidated

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<sup>24</sup> See *Town Planning Eng'g Assocs., Inc. v. Amesbury Specialty Co.*, 342 N.E.2d 706 (Mass. 1976); *Hastings Assocs., Inc. v. Local 369 Bldg. Fund, Inc.*, 675 N.E.2d 403 (Mass. Ct. App. 1997).

<sup>25</sup> See *TAL Financial Corp.*, 844 N.E.2d 1085; *Honey Dew Assocs., Inc. v. M & K Food Corp.*, 241 F.3d 23, 27 (1st Cir. 2001).

<sup>26</sup> *TAL Financial Corp.*, 844 N.E.2d 1085.

<sup>27</sup> See *Kelly*, 705 N.E.2d; *Clean Harbors, Inc. v. John Hancock Life Ins. Co.*, 833 N.E.2d 611, 618 (Mass. Ct. App. 2005).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* See also, *Perroncello v. Donahue*, 859 N.E.2d 827 (Mass. 2007); *NRT New England, Inc. v. Moncure*, 937 N.E.2d 999, 1003 (Mass. 2010).

<sup>30</sup> See *TAL Financial Corp.*, 844 N.E.2d 1085; *A-Z Servicercenter, Inc. v. Segall*, 138 N.E.2d 266 (Mass. 1956); *Perfect Solutions Inc. v. Jereod, Inc.*, 974 F.Supp. 77, 83 (D. Mass. 1997).

<sup>31</sup> *Kelly v. Marx*, 705 N.E.2d 1114 at 1117 (Mass. 1999); See also, *NRT New England*, 937 N.E.2d at 1003 (enforcing a liquidated damages clause in agreement for purchase and sale of real estate providing for 5% of purchase price).

<sup>32</sup> See *Howard*, 811 N.E.2d at 1052 (holding that liquidated damages of \$1000 was not unreasonably low considering this was to cover damages incurred over 11 day period); See also, *Kunelius v. Town of Stow*, 588 F.3d 1 (1st Cir. 2009) (upholding a 2% liquidated damages clause since the “vendor failed to produce evidence that the amount was grossly disproportionate to a reasonable estimate of her actual damages at the time of contract formation”).

damages provisions as high as 20%.<sup>33</sup> However, there is a limit, as “a provision setting an unreasonably large liquidated damages amount is unenforceable on public policy grounds as a penalty.”<sup>34</sup>

**10. Are actual damages relevant for liquidated damages, and in particular, will liquidated damages be allowed when there are no actual damages?**

In Massachusetts, liquidated damages are allowed even if there are no actual damages.<sup>35</sup> For purposes of determining whether a liquidated damages provision should be enforced, the “inquiry is limited to the time of contract formation; Massachusetts courts do not take a “second look” at the actual damages after a party breaches.”<sup>36</sup> However, this does not make actual damages irrelevant. Actual damages are relevant in so far as they provide a point of comparison in determining whether a liquidated damages clause grossly overestimated or underestimated a party's damages at the time of contract formation.<sup>37</sup>

**11. Is mitigation relevant for liquidated damages?**

Mitigation is not relevant for liquidated damages.<sup>38</sup> “Massachusetts follows the rule in other jurisdictions holding that, in the case of an enforceable liquidated damages provision, mitigation is irrelevant and should not be considered in assessing damages.”<sup>39</sup> When parties agree in advance to an amount they believe represents a reasonable estimate of potential damages, “they exchange the opportunity to determine actual damages after a breach, including possible mitigation, for the peace of mind and certainty of result afforded by a liquidated damages clause.”<sup>40</sup>

**12. Is a shotgun clause acceptable?**

A shotgun clause fixes a single large sum as the liquidated damages for any breach of the contract. Whether this type of provision would be enforceable under Massachusetts law depends upon the circumstances. If, in all of the circumstances in which the shotgun clause were to apply, the amount provided for is reasonable, the shotgun clause may be

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<sup>33</sup> See *Edlow v. RBW, LLC*, 688 F.3d 26 (1st Cir. 2012) (holding that a liquidated damages provision permitting condominium developer to retain 20% of purchase price in event of breach by prospective purchaser did not constitute an unenforceable penalty).

<sup>34</sup> *Colonial at Lynnfield, Inc. v. Sloan*, 870 F.2d 761, 764 (1st Cir. 1989).

<sup>35</sup> See *Perroncello v. Donahue*, 859 N.E.2d (stating that even if the seller finds another buyer to purchase the property for a price the same or higher than the original contract price, liquidated damages provision is enforceable). See also, *Kelly*, 705 N.E.2d at 1117 (enforcing a liquidated damages provision where the seller sold the property at a higher price, and had realized an actual gain as a result of the buyer's breach).

<sup>36</sup> *Kelly*, 705 N.E.2d at 1117.

<sup>37</sup> *Kunelius*, 588 F.3d 1. See also, *TAL Financial Corp.*, 844 N.E.2d 1085 (stating that the disparity between the stipulated sum and actual damages could not be ignored because it was known at the time of the agreement); *Kelly*, 705 N.E.2d at 1116 (holding that a liquidated damages provision will not be enforced if it provides for an amount “grossly disproportionate to a reasonable damages estimate made at the time of contract formation”).

<sup>38</sup> See *NPS, LLC v. Minihane*, 886 N.E.2d 670 (Mass. 2008) (holding that “as a matter of apparent first impression, in the case of an enforceable liquidated damages provision, mitigation of damages is irrelevant”).

<sup>39</sup> *Kelly*, 705 N.E.2d

<sup>40</sup> *Id.*

upheld. Thus, if the shotgun clause reflected the loss anticipated at the time the contract was executed, particularly if it was either difficult to prove that loss occurred or to capture the amount of that loss, the clause will likely be enforced, irrespective of what the actual loss ended up being.<sup>41</sup> In reality, however, it would likely be difficult to have a shotgun clause that provides for a reasonable amount of damages in connection with all potential contract breaches and, as a result, using the shotgun approach to liquidated damages may increase the chances that a Massachusetts court would find the provision to be unenforceable.

### ***13. Do liquidated damages preclude recovery of attorney's fees?***

Liquidated damages do not preclude recovery of attorney's fees.<sup>42</sup> Whether attorney's fees are recoverable depends on the terms of the contract.<sup>43</sup> However, the award of attorney's fees in the contract must be reasonable and is a "highly discretionary matter usually left to the judge."<sup>44</sup>

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<sup>41</sup> See *Colonial at Lynnfield, Inc. v. Sloan*, 870 F.2d 761, 764 (1st Cir. 1989); *A-Z Servicerter*, 138 N.E.2d 266 (Mass. 1956); *Lynch v. Andrew*, 481 N.E.2d 1383, 1386 (Mass. App. Ct. 1985).

<sup>42</sup> See *Kelley v. Weyerhaeuser*, 422 N.E.2d 465, (Mass. App. Ct. 1981) (allowing recovery of attorney's fees in a liquidated damages case under a lease).

<sup>43</sup> See *TAL Financial Corp.*, 855 N.E.2d (holding that although attorney's fees can be awarded in conjunction with a liquidated damages provision, they must be reasonable in light of the recovered damages).

<sup>44</sup> *Id.*