

legal

Benefits, Pitfalls of Liquidated Damages

BY MARK A. KABLACK

The Massachusetts Appeals Court has thoughtfully reminded us of the benefits and pitfalls of the liquidated damages clause in purchase-and-sale agreements.



In a case decided in September 2005, *Perroncello v. Donahue* (2005), the Appeals Court upheld a seller's rights to liquidated damages, overturning a lower court decision in buyer's favor.

The case provides a valuable reminder to buyers, sellers, builders and developers of the meaning and importance of boilerplate clauses within real estate agreements, and how actions or inactions after signing an agreement may or may not affect the written word.

In 1998, Donahue (as seller) and Perroncello (as buyer) entered into a purchase-and-sale agreement where the sale price was set at \$2.25 million; a deposit was tendered for \$150,000; a closing date of May 6, 1998, was set; and the buyer was granted an option to extend the closing date to June 5, 1998, by written election to the seller and the payment of certain carrying costs. The agreement contained the typical clauses regarding the deposit, stating that the deposit was non-refundable and would serve as liquidated damages in the event of a buyer breach. The agreement also contained the typical "time is of the essence" clause with respect to the closing date and other time deadlines within the agreement.

The buyer elected its option to extend the

closing date to June 5. But, as the extended date approached, buyer had not obtained a formal commitment for mortgage financing. On the day prior to June 5, and in the days that followed, there were numerous communications between buyer and seller, and their counsel, regarding the closing date, timeline for mortgage financing and requests for extension. Despite "making light" of the delay and continuing to encourage buyer to secure financing, the seller's counsel sent two letters that proved in the end to be crucial in the case. The first letter, sent on the extended closing date (June 5), served as formal notice that June 5 continued to be the date of performance under the agreement. The second letter, sent one week later, stated that the seller considered the agreement to be in breach and that the deposit had been forfeited.

By the end of June, the buyer had filed a complaint in Superior Court and a motion for endorsement of a *lis pendens*, which was allowed. After months of negotiation while the case was pending, the seller offered a motion to dismiss and offer of judgment of specific performance. In response to the seller's offer of judgment, the judge in Superior Court ordered the property sale but preserved the remaining counts and counterclaims in the case, stating specifically that such matters would survive the closing and that the parties would be entitled to pursue monetary damages. The closing took place under the judge's order on Sept. 23, 1998.

Following the closing, the buyer dropped all his remaining claims in the Superior Court case and moved for summary judgment against the seller's surviving claims for liquidated damages and damages under Massachu-

setts General Laws chapter 93A. The summary judgment motion was granted to buyer, dismissing seller's claims, and seller subsequently brought the current appeal.

Language Strictly Construed

The Appeals Court decision, authored by Judge Gordon L. Doerfer, upheld the summary judgment dismissal of seller's chapter 93A claims, but overturned the lower court decision as it related to breach of contract and liquidated damages. The Appeals Court was not swayed by the fact that the purchase-and-sale agreement was "substantially performed," or that the seller received his "expectation interest" (the sale price) as a result of the court-ordered closing. The Appeals Court, instead, strictly construed language in the agreement regarding "time is of the essence" and "liquidated damages."

Despite the factual history of this case, the Appeals Court ruled that the buyer did in fact breach the agreement. While some actions may overcome or waive the certainty and importance of "time is of the essence" clauses, the court was not convinced that any of the actions by seller in this case clearly amounted to a waiver. The court found buyer's interpretations of seller's actions and statements to be subjective. In the court's view, there was nothing in the record of a concrete nature demonstrating that the seller was willing to extend the closing schedule or to work with buyer on rescheduling. The court reiterated prior decisional law stating that post-breach discussions (the willingness to talk and or negotiate after a breach has occurred) do not in and of themselves constitute a waiver of rights. In essence, failure to close on a certain date was a breach,

and the seller was well within rights to pursue contract damages in light of the fact that the lower court ruling preserved such rights in the order for judgment.

More importantly, the Appeals Court took an equally stringent view toward the liquidated damages clause in the agreement. The court acknowledged that liquidated damage provisions are commonplace in real estate agreements. The Court also explicitly rejected the so-called "second look" approach to such clauses, meaning that it will not conduct hindsight review of whether the recipient of liquidated damages ultimately receives a windfall payment. The court cited to the case of *Kelly v. Marx* (1999), wherein the Supreme Judicial Court upholds liquidated damage payments to a seller who eventually sells real estate for more than the original contract price. In *Perroncello*, while acknowledging that the eventual sale to the buyer creates unusual factual circumstances, the Appeals Court holds that such an aftermath is irrelevant to the assessment of whether liquidated damages should be awarded to seller or not.

While review has been granted by the Supreme Judicial Court in the *Perroncello* case, the case serves as a warning to all buyers and sellers to be cognizant of the terms and conditions of a written agreement, even if such language is boilerplate and customarily overlooked. The liquidated damage provisions in most real estate agreements are alive and well in the commonwealth of Massachusetts. Currently there appears to be little or no equitable ground for argument that liquidated damages should be voided and a deposit returned, even when a seller may eventually become whole or receive consideration in excess of the original

contract price. Secondly, buyers and sellers should be conscious of deadlines and timetables, particularly where third parties (mortgage lenders) are involved. If a date must be extended, the extension should be requested in advance of the deadline, the extension should be in writing and the extension should be clear as to its intent and purpose.

Additional Case Update

In an earlier MassBuilder edition (second quarter 2004), I reported on a Superior Court case entitled *Hobbs Brook Farm Property Company Limited Partnership v. Conservation Commission of Lincoln* (Middlesex Superior Court, January 2004). The *Hobbs* case, while not binding precedent, was important as it recognized that in certain instances a decision under the Wetlands Protection Act (WPA) can preempt a pending appeal and decision under a wetland protection bylaw. This decision was important in light of the bifurcated appeals process builders and developers face when they receive an adverse decision under both the WPA and a wetland bylaw. A WPA appeal must be brought through an administrative appeal process with the Department of Environmental Protection (through a request for a superseding order of conditions, and subsequent administrative appeal), while a wetland bylaw appeal must be brought in Superior Court (through a writ of certiorari). The potential opportunity for the administrative process to preempt the Superior Court appeal requirement can cut the time delays of an appeal process in half. Such economies are crucial in light of the impact of local wetland regu-

lations on housing production and pricing (see the report entitled: "Regulation and the Rise of Housing Prices in Greater Boston," by Edward L. Glaeser, Jenny Schuetz and Bryce Ward, Harvard University, January 5, 2006).

The preemption afforded in the *Hobbs* case was dependent upon the lower court's finding that the Wetland Protection bylaw in the town of Lincoln provided no further protection of the wetland resource area than the protections afforded by the WPA. In a recent appeal of the *Hobbs* case to the Massachusetts Appeals Court, however, the Appeals Court overturned the lower court ruling. The Appeals Court held the Lincoln bylaw provided additional wetland protections when compared to the WPA in three areas: it afforded direct consideration of erosion and sedimentation control; it contained a more stringent evidentiary standard in the consideration of effects or impacts to wetland areas and the avoidance thereof; and it required a broader geographic and economic scope of alternatives.

The appellate decision in *Hobbs* is a setback to the building and development community. As of this writing, I understand that a further appeal of *Hobbs* to the Massachusetts Supreme Judicial Court is being considered. This case will continue to be watched for its important value in the discussion of local wetland regulations and the impact of such regulations on housing production and pricing. ♦

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