

Bench Brief

Broker Commissions: No Rule Against Perpetuity?

by Brian A. Mills

It is common for commercial real estate brokers to contract for the right to receive a commission, typically five percent of the cumulative net rents paid for an entire lease term, both upon the execution of a new lease and any renewal. Courts have deemed these commission agreements ‘personal’ in nature. Consequently, when a property is sold, the broker lacks contractual privity with the new owner, and may find it difficult to enforce the renewal commission provision of the listing agreement against the new owner.

The Supreme Court’s recent decision, *Pagano Company v. 48 South Franklin Turnpike, LLC*,¹ which ruled in favor of a broker against a purchaser, gives brokers ammunition in their battle to protect their income stream after the sale of a property, and magnifies and expands the responsibility of the attorney representing buyers and sellers of tenanted properties. The Supreme Court’s prior decision on this issue, *VRG Corp. v. GKN Realty Corp.*,² found “no obligation on the purchaser’s part to pay the broker unless the purchaser affirmatively assumes that obligation.”

To reconcile the seemingly inconsistent rulings, the Court did not expressly reverse *VRG*. Rather, it broadened the circumstances under which a purchaser is said to have “affirmatively assumed” a commission agreement. In doing so, the Court arrived at what some would find a curious outcome, essentially finding that the buyer constructively affirmatively assumed the obligation to pay renewal commissions.

In so holding, the Court found persuasive a broad due diligence provision in the purchase contract paired with the language in the leases making reference to “a separate commission agreement.” Despite the undisputed fact that the buyer was never given the commission agreement, the Court found the reference in the leases (which were provided to the buyer during due diligence) sufficient to put the buyer on notice of the existence of a commission agreement, and deemed the purchaser to have affirmatively assumed the obligations.

It is now incumbent on practitioners representing buyers of tenanted commercial properties to closely review all

leases in effect at the property. If the lease mentions a listing agreement, the attorney must request a copy and inform his or her client of the possible obligation to pay renewal commissions.

If the obligation will be enforceable against the buyer, the attorney should discuss with the buyer whether the contract price reflects the additional expense that will be incurred upon a renewal. The attorney may also wish to counsel his or her buyer to consider these potential obligations when determining whether it can satisfy any financial ratios required by its financing. Out of an abundance of caution, the attorney may even wish to make this recommendation if the leases merely identify a broker without making reference to a commission agreement.

Perhaps even more important, attorneys representing sellers must take additional steps to ensure their clients are not responsible for commissions for renewals that occur at a building or property they no longer own, especially if the seller is, as is often the case, an entity created solely for the purpose of owning the property.

A board of directors could issue a distribution of the sale proceeds to shareholders thinking the transaction completely closed the entity, only to be subsequently found liable for commissions. In such a case, the lawyer will have an angry cadre of shareholders, and an even angrier board of directors, knocking at his or her door. Consequently, a lawyer representing a seller cannot rely on the bundle of sticks theory to effect complete transfer of all contracts and obligations pertaining to real property. An assignment and assumption agreement expressly transferring the leases and all obligations is mandatory to protect the seller post-closing. ☞

Endnotes

1. 198 N.J. 107 (2009).
2. 135 N.J. 539 (1994).

Brian A. Mills practices with Maselli Warren, P.C., in Princeton.