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Broker commissions and subsequent owners

New Jersey courts have affirmed the law on whether subsequent owners of real property are liable for broker commissions under agreements executed by prior owners of that property.

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In the recent decision *Pagano Co. v. 48 South Franklin Turnpike, LLC* (decided March 3, 2008), the New Jersey Superior Court Appellate Division held that for a leasing agreement between a broker and prior property owner to be enforceable against a subsequent owner of such property not a party to such broker agreement, a mere assumption of leases — without an express agreement by purchaser to pay commissions pursuant to the broker agreement — is not sufficient to create an obligation of the purchaser to the broker for subsequent commissions claimed under the leasing agreement with the broker.

Facts

In *Pagano*, the predecessor in title had entered into an exclusive leasing agreement with a broker pursuant to which the owner agreed to pay commissions to the broker on the lease and renewal options exercised by tenants on the property. When the subsequent

purchaser acquired the property, the purchaser accepted an assignment of the leases that burdened the property. The assignment document provided that the new owner “assumes and agrees to perform” all of the predecessor’s obligations under the leases, but the exclusive leasing agreement between the prior owner and the broker was neither assigned to nor assumed by the purchaser. Nonetheless, the broker argued the purchaser was liable to the broker for commissions by virtue of its assumption of the leases.

The court disagreed: The subsequent purchaser had merely agreed to assume the obligations under the leases. There were no references in the purchase agreement, closing documents, assignment or any other documents evidencing the subsequent purchaser explicitly promised or intended to pay commissions to the broker. The broker was not a party to the lease, and more importantly, the court held there were no promises made to the broker in the lease.

Thus, according to *Pagano*, if a purchaser has not expressly agreed to pay commissions to a broker, an obligation to pay will only arise — absent an express assumption of the



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leasing agreement — if the lease sufficiently details the lessor's obligation to pay the broker commissions.

However, many leases do not provide such detail because the landlord has no obligation to do so. In addition, the parties to a commission agreement may prefer not to make others aware of such agreement terms, these being private arrangements that may fluctuate from deal to deal. Nevertheless — and as in *Pagano* — many commercial leases generally do

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provide (1) such a broker arrangement exists; and (2) that the current lessor is liable for payments due under such arrangements. Per *Pagano*, this detail is insufficient to shift liability for such commission payments to the subsequent purchaser under these circumstances.

Is this a fair result? The answer may depend on the readers' perspective: A broker would argue that a purchaser's non-liability for commission payments was unjustly enriched, as the broker did provide services in providing tenants for the property.

The purchaser, however, would contend the price paid for the property was based on the existence of the leases; thus there could be no unjust enrichment.

New Jersey case law regarding the issue of subsequent owner liability for broker commissions has been primarily focused on three claims: (1) a direct breach of contract claims pursuant to a broker recognition provision in the assigned (and assumed) lease agreement; (2) equitable lien claims; and (3) claims of unjust enrichment.

Direct breach of contract

When property is sold subject to a lease, there is no obligation on the purchaser's part to pay the broker, unless the purchaser affirmatively assumes such obligation. *VRG Corp. v. GKN Realty Corp.*, 135 N.J. 539 (1994). However, if the purchaser assumes the underlying lease and the broker provision in that lease contains a promise on the part of the landlord to pay the broker that is so clearly delineated as to be considered an agreement itself within the lease, the purchaser would be liable for those commission payments on purchase of the property and assumption of the lease. See *Bacharach v. Mitnick*, 121 N.J.L. 401, 402 (S.Ct. 1938).

Equitable liens

The *VRG Corp.* court also addressed the broker's agreement that an equitable lien exists on rental payments continuing after sale of the property to a subsequent owner.

In *VRG Corp.*, the leasing agreement provided the owner would pay a commission based on each monthly rental payment received from the procured tenant. The subsequent owner assumed the leases but refused to pay the broker. The broker argued it was entitled to an equitable lien on the rental proceeds for its commissions. The trial court held no equitable lien existed because the owner "did not specifically express the intent to pay commissions from the rental proceeds." The appellate court disagreed, finding that although the commission payment was both contingent on and measured by the rental income, the actual rental income was not the source of such payment. The two-justice dissent could not make such a distinction.

Unjust enrichment

As regards establishing the third claim, unjust enrichment, the New Jersey Supreme Court held "a plaintiff must show both that defendant received a benefit and that retention of that benefit without payment would be unjust." The equity-based claim also "requires that plaintiff show that it expected remuneration from the defendant at the time it performed or conferred a benefit on defendant and that the failure of remuneration enriched defendant beyond its contractual rights." *VRG Corp.*, 135 N.J. at 554.

In the aftermath of *Pagano*, purchasers seeking to avoid liability under existing leasing commission agreements must refrain from assuming such obligations. A prudent purchaser will need to review the underlying leases to confirm no affirmative payment obligations exist in order to avoid an unintentional consequence of its assumption of the leases. Brokers should be forewarned that if the property is sold, their rights to collect commissions, including renewal or extension commissions, from a purchaser of the property may be terminated under *Pagano*, notwithstanding a purchaser's knowledge of the commission agreement and express assumption of the leases. ☉