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Listings, Leases, and Liabilities

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MIDCOURSE CORRECTIONS

Listings, Leases, and Liabilities

Roger Bernhardt

Introduction

The decision in *Blickman Turkus, LP v MF Downtown Sunnyvale, LLC* (2008) 162 CA4th 858, 76 CR3d 325 (reported at p 118), could have been a rich source of guidance for attorneys interested in commercial brokerage matters, since the attorneys raised some questions about brokers' commission rights and liabilities. Instead, however, because the court begins in the middle of the case and then spends most of its lengthy opinion on what appear to be pleading rather than substantive issues, I fear that the parties alone will gain very much from reading it. That makes this column mostly one on what might have been (with the facts recited being derived as much from a reading of the parties' briefs as from the court's opinion).

The Commission

The litigation was commenced by a cooperating broker for its share of part of a commission it claimed was fully earned. The original listing agreement that the landlord had negotiated with its own broker to find a tenant provided that one half of the commission would be paid when a lease was initially executed and the other half when the landlord began to be paid (after the landlord's completion of construction of the improvements, estimated to occur over a year later). That second half was not paid, and the cooperating broker—the one who had procured and represented the tenant—brought an action against the landlord, for its part of that half, about \$850,000.

This claim is barely mentioned in the opinion, but it appears that the trial court had ruled that the balance of the commission had never become due because the landlord and tenant had negotiated a termination of the lease before the tenant ever started paying any rent. Since no one appealed that ruling, there was no coverage of that point in the appellate opinion.

Now, no party is forced to file an appeal just so that I can get answers to questions I might have, but I would have greatly wanted to know when and under what circumstances premature termination of a lease ends a leasing broker's entitlement to a commission. In purchase situations, brokers frequently do not receive their commissions until close of escrow, but maintain, at the same time, that failure to close will not automatically terminate the right to a commission. There is a difference between a date of legal entitlement to a commission and the date for actual receipt of it, so I have to wonder: Why was the final part of the commission denied here, after a ready and able tenant had been signed up?

From the briefs, I surmise that the trial court accepted the landlord's contention that the listing provision making that second half of the commission "due and payable" when rent

commenced—rather than just “payable”—meant that the obligation to pay dissolved if the tenant was later released from its rent obligations before part of it was paid. But that is a heavy significance to impose on those two little words (“due and”); I doubt that most persons in the real estate community fully appreciate it. If that is how the distinction now works, then lawyers should henceforth make sure that this feature is duly noted in their forms and taught to their clients (and new associates).

Furthermore, in this case, the landlord seems to have been paid some \$50 million for letting the tenant get off the rent hook. While the trial court held that such money was not rent, it pretty clearly looks that it was paid as a substitute for rent (or as a substitute for not having to pay rent), rather like the forfeited deposit of a defaulting purchaser that is treated as liquidated damages and then usually split between seller and broker in lieu of payment of a full commission, except that this money was paid as the result of an entirely consensual arrangement between parties (which may make it seem more, rather than less, like rent). Given the result here, attorneys representing brokers or the parties they deal with need to put more thought and effort into negotiating those “no deal, no commission” provisions that appear in listings.

This was only a trial court ruling, but its outcome could happen to anybody.

Disclosure

The issue that did go up on appeal was the landlord’s claim that the broker knew that the tenant was heading toward financial failure but did not disclose that to the landlord. This contention was raised in the landlord’s cross-complaint to the above-mentioned broker’s initial complaint for the commission, not as a defense to payment of the commission, but rather as a basis for affirmative tort liability. In contrast to the undiscussed commission issue, this nondisclosure theory was so overkilled in the opinion that we come away not knowing which of the many reasons given for its rejection is the one to take seriously and learn from. (The opinion makes it hard to tell whether it is a procedural or substantive ruling; it is rife with condemnations of the way the theory was pled (“a model of improper pleading”; “allegations [that] are woefully deficient”; “pregnant with fatal ambiguities”). I am skeptical, because all counsel were very competent and highly regarded real estate attorneys. I will ignore the judicial recriminations and focus on the theory itself.)

The claim was that since the broker had learned before the termination of the lease that the tenant was going under, such information should have been disclosed to the landlord. It was rejected because this information (1) had come to the *cooperating* broker (2) by way of a *confidential* communication (3) *after* the lease had already been executed and (4) had caused no legal *damage* to the landlord (my categories). It is this overabundance of reasons that makes it so hard for others to estimate how valid each ground might have been on its own (although I am now about to try to do just that).

Agency

The broker who had not made the disclosure was the agent of the tenant, not the landlord. (A sort of potential dual agency was also claimed, but under a contingency that the court felt free to ignore.) Of course, a landlord’s own agent has a fiduciary obligation to pass on to it any potentially significant information, but what burden, if any, is imposed on the agent for the other party? The landlord’s assertion that the general obligation of truthfulness and honesty covering

all brokers generated the same disclosure duty on the nonagent broker was rejected, but because of all of the other grounds for rejecting the claim, it was not that seriously considered on its own.

If a cooperating broker presents a buyer or a tenant to the other side while being in possession of some unpleasant information about the client, does the failure to mention that constitute fraud? I expect that the duty on the side of the seller and her agent not to withhold facts regarding defects in the property is matched on the other side as to information about defects in the buyer's (or tenant's) ability to pay. Saying that this was the cooperating broker rather than the listing broker should not end the inquiry as to the scope of disclosure duties, as might seem to be implied by this opinion. Certainly, I would not feel comfortable advising a broker client that she need not disclose some adverse fact she knows merely because she is on the other side of the deal.

Confidences

A plausible exception to a duty to disclose often exists when the information comes as a confidential communication. Lawyers know not to tell the other side what their own clients have admitted to them in confidence, but how true is that for brokers? When a seller tells her broker about a concealed defect in the property, is he similarly bound to keep it secret? The opinion says that an obligation to disclose in that case would "make it impossible for any principal to conduct negotiations through an intermediary," and that seems inarguable. But does that proposition resolve all difficulties? Does it insulate a broker from liability for fraud in all cases, *e.g.*, even if he affirmatively responds to a question from the other side with a lie because his principal has told him to do so? Should he quit his job instead, as the opinion acknowledges? What if he is a dual agent, as brokers so often love to become? Concluding that the information about a client's financial woes came from confidential communications may be only the beginning of all that an attorney needs to know when her broker client inquires as to the scope of its disclosure duty to the other party in the deal.

Duration

How long after the initial stage of having made an offer do disclosure duties last? Are those duties the same for matters learned after the offer was accepted but before the escrow has closed? Do any duties continue after close of escrow? In this case, the lease had been signed before the broker learned about the trouble, but the rent payments had not yet started. Nor, obviously, had the brokers received the second half of their commission. Nor had the termination and restructure negotiations commenced. The court's observation that the critical conduct did not occur until after execution of the lease may be enough to support its conclusion that there was therefore no fraudulent inducement to enter into a lease, but it does not support much else. I remain unsure of what to tell a broker as to how long afterwards he can safely keep his mouth shut.

Damage

The landlord claimed that he could have made a much better settlement with the tenant if he had been told earlier, *i.e.*, he could have found a new tenant and made more money. The court's response that he was not legally free to do so until this lease was terminated seems glib, since there had been real fraud (*e.g.*, proven intentional disloyalty by one broker or affirmative misstatements by the other). I think that belatedly informing could be deemed material in a volatile market. When to begin worrying that an existing tenant may be in trouble and when to start looking for a replacement are matters that many landlords may expect their rental agents to

handle for them. Attorneys should advise brokers that they may not be excused from their obligations to inform their principals just because they don't know what they could do about it if they knew.

Attorney Fees

The landlord's motion for attorney fees in defeating the broker's original commission claim was rejected on the ground that the clause in the listing agreement covered only "litigation between the parties hereto," which did not include the cooperating broker. In affirming that decision, the court rejected what it called the "playground justice" argument that unjustified fees can be awarded just because the other party has similarly requested them—a holding that should remind litigation counsel to warn clients about the potential unprofitability of some claims. (The landlord's attorney fees were set at \$496,000 for fighting the broker's \$850,000 claim.)

There seems to have been no claim for attorney fees by the tenant's broker for defeating the landlord's nondisclosure cross-complaint. Perhaps an economic calculation convinced them that they were better off having both fee claims rejected rather than accepted and somehow offsetting each other. Since I have no idea how an attorney fee award would have been calculated had such fees been covered in the contract and had each side prevailed on its respective claim, that is one part of the decision I cannot complain about

Blickman Turkus, LP v MF Downtown Sunnyvale, LLC (2008) 162 CA4th 858, 76 CR3d 325

Commercial Property Services (CPS) entered into a listing agreement, on commission (to be paid one half on lease execution and one half on commencement of rent), to obtain a lessee for buildings to be built on property owned and managed, respectively, by MF Downtown Sunnyvale, LLC and Mozart Development Co. (collectively, Mozart). In early 2001, Mozart signed written leases with Handspring, Inc. for two buildings to be completed to Handspring's specifications by approximately September 2002. Handspring's obligations were secured by letters of credit. Blickman Turkus, LP, doing business as BT Commercial Real Estate (BTC), represented Handspring in the lease transaction. Handspring began to have financial difficulties beginning in October 2001. Mozart learned of Handspring's financial problems in August 2002, when it was contacted by another agent for Handspring to negotiate a termination of the leases. In exchange for termination of the leases, Mozart received stock, notes, and cash, and was permitted to draw on the letters of credit for a total consideration valued at more than \$50,000,000.

BTC claimed that it was the procuring agent and entitled to a commission under Mozart's listing agreement with CPS. Claiming that Mozart had paid the first half of the commission but had refused to pay the second, BTC asserted claims for breach of contract, the covenant of good faith and fair dealing, an implied promise to complete the lease transaction, and tortious interference with advantageous relationship. Mozart cross-claimed, alleging that BTC had been aware of Handspring's financial problems as early as October 2001 and had failed to inform Mozart, which suffered damages as a result. Mozart and BTC both successfully challenged the other's claims before trial, and the superior court entered judgment that neither party take anything. Mozart's motions to vacate the judgment and for attorney fees were denied. Both sides appealed. The court of appeal affirmed the judgment.

The fatal flaw of Mozart's cross-claims was that BTC had no duty to disclose to Mozart the information about Handspring's financial problems—whether as agent for Handspring or, hypothetically, for Mozart or as a result of representations made at the time Handspring entered into the lease. Mozart never believed or rationally could have believed that BTC represented Mozart's interests. Moreover, there was no evidence in the record of any basis for Mozart to expect that BTC would disclose Handspring's confidential information other than as Handspring might direct. Nor was there any duty for BTC to correct statements, made before execution of the lease, that allegedly became incorrect thereafter. Mozart sought to recover for alleged harm not in entering into the lease, but from the failure to withdraw from the lease sooner than it did. Mozart's claims based on dual agency also failed because even if BTC were a dual agent, its obligation, when faced with a conflict between two principals, would be to withdraw from the representation rather than to disclose confidential information. Mozart's claim for attorney fees failed as well. Even if BTC had succeeded in its claims, it would not have been entitled to attorney fees because it was not a party to the contract (between Mozart and CPS) containing the attorney fee provision.