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Brokers' Commissions Under Conditional Contracts

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RC Royal

Attorneys should probably take much of the language in *RC Royal Dev. & Realty Corp. v Standard Pac. Corp.*, reported at p 155, with skepticism, but at the same time, they should remember it as a cautionary warning of the potential liability of clients who try too hard to avoid honoring a commission to their broker that a court believes should have been paid.

Under the buyer-broker agreement executed in this case, the broker was entitled to a commission when the buyer "purchased ... any direct or indirect beneficial interest in the property." This provision led the court to believe that it had to decide whether the contract that the buyer had executed with the seller gave it "equitable title"—*i.e.*, the necessary "beneficial interest" in the property. (Under the California Association of Realtors standard form captioned "Buyer Representation Agreement," a commission is earned when the buyer "enters into an agreement to acquire property," which phrase might have obviated the court's perceived need to decide whether a beneficial interest had been acquired, although the tenor of the opinion makes it likely that the court would have construed the two provisions the same way.)

I doubt that either provision accurately describes what lawyers ordinarily expect to be the outcome in buyer-broker commission disputes. The mere execution of a purchase contract does not generally entitle a buyer's broker (or, for that matter, a seller's broker) to a commission *if the contract is conditional*; nor does equitable title pass to a buyer upon the simple execution of a conditional contract. More has to happen.

To illustrate this, let me work up to it in several steps. Starting with a more common situation, a seller's broker does not earn a commission simply because he has presented an offer from a purchaser, even if it is at the price listed by the seller. The offering purchaser must also be "ready, willing, and able," which is not the case when the offer is conditional, *e.g.*, subject to obtaining a loan. That is also true for a conditional offer that has been actually accepted by a seller, whether at the listing price or at some other number. In these situations, it is not until the conditions have been met—or waived—that a commission is earned. Until the conditions are met (*i.e.*, the loan is obtained), the purchaser is not ready and willing.

In this case, the broker was representing a buyer and seeking a commission from the buyer after a failed sale. The $116 million purchase contract gave the buyer one month (from August 19 until September 14, 2005) to be satisfied about certain matters, which condition was apparently met, and also gave the buyer an additional period of at least three months (until "in no event earlier than January 4, 2006") for a certificate of occupancy to be issued and a final map to be recorded. Which party had the obligation to get those conditions satisfied is not expressly stated in the opinion; however, the fact that the buyer was willing to forfeit its $4 million deposit makes it probable that it was the buyer's responsibility.

The trial court read the contract to mean that the buyer was not liable for a commission because at least one of those conditions (the occupancy permit) had not been satisfied. That looks

right, given the rules about conditional contracts. I do not agree with the trial court's further conclusion that escrow had to actually close in order for liability to arise; the ready, willing, and able purchaser doctrine imposes, as a consequence, that the contract need not be consummated for a commission to be earned unless expressly so required by the listing. But, since all conditions had not been met, it does not seem like error for the trial court to hold that no commission had been earned. That would also be the result I would reach if the listing agreement said "purchase a direct or indirect beneficial interest in the property" rather than "enter into an agreement to acquire the property," because equitable conversion does not arise until a purchase contract has become unconditional. (See *Paar-Richmond Indus. Corp. v Boyd* (1954) 43 C2d 157, 272 P2d 16.) Any error about escrow having to close seems harmless in light of the fact that some conditions were not met.

But the court of appeal took a different view: "Once Standard Pacific entered into a buy-sell sale contract containing all of the essential terms of purchase, it obtained equitable title. With equitable title, Standard Pacific had a 'beneficial interest' in the property and RC earned its commission." That conclusion, it seems to me, is at odds with settled law about brokers' lack of rights to a commission when the underlying purchase contract is conditional.

It is true that there are times when a principal may be estopped from asserting that a precondition was not met. When nonoccurrence happened because of the principal's own acts that prevented it from happening, the broker may be entitled to a commission anyway. Thus, for example, a seller probably could not escape liability for a commission to her broker under a sales contract that was conditioned on the buyer getting a loan if the seller refused to let an appraiser inspect the property for loan purposes.

Courts often explain that sort of result by referring to the implied covenant of good faith, but that is a really misleading label. If a party can get itself out of a contract that has become burdensome by taking advantage of a condition or provision in it, his or her lawyer probably ought to advise doing so. Good faith does not compel a party to ignore the express terms of the agreement. A better explanation should be found for this very understandable result. (I say this because the final part of the *RC Royal* opinion—which was included in the Daily Journal version of this case, which I read before I realized that that part was nonpublished—went heavily into good faith moralism, holding that "the buyer impliedly promises to complete the transaction so that the broker can recover the commission." Such language does appear in *Chan v Tsang* (1991) 1 CA4th 1578, 3 CR2d 14 (reported at 15 CEB RPLR 139 (Apr. 1992)), but it may have been more appropriate there because that broker had no written listing agreement with its buyer and needed to make use of the buyer's formal purchase contract with the seller in order to have a claim at all. I do not think that any buyer is expected to go through with an unwanted purchase, even when the seller is willing to let her out, only to see that her broker is paid. I think the broker does not care at all about whether a sale is completed, as long as he is paid a commission. We should tell clients that backing out of a contract with a principal may possibly create a liability to an agent in the transaction, but advising that he or she has to complete the main contract because of a duty of good faith owed to that agent sounds more like priestly than legal advice. I am relieved that this part of the opinion was not published.)

Since there is no mention in the appellate opinion of any bad acts on the buyer's side entitling a court to ignore the nonoccurrence of the conditions on which the contract was dependent, that seems to put me closer to the trial court than to the court of appeal. Actually, I think I am in the middle. The trial court believed that no commission would be earned unless and until escrow

actually closed, while the court of appeal believed that the commission was earned as soon as the purchase contract was signed. I think the signing of the contract was too early—because the contract was conditional—and that the close of escrow was too late—because the necessary conditions could have been either met or waived sooner. If the broker ever does prevail, this timing difference could matter, because it should trigger the running of interest on what may be a very large sum.

Postscript

New legislation effective October 11, 2009 (Stats 2009, ch 630 (SB 94-Calderon, Corbett & Steinberg)), prohibits the collection of advance fees for services rendered in modifying home mortgages (CC §2944.7) and requires large print disclosure of that fact (CC §2944.6). This is important to know because these new statutes are urgency measures, effective immediately, and are companioned by new Bus & P C §6106.3, which imposes discipline on attorneys who violate them.