Premature Compensation and How to Prevent Unpleasant Brokerage Surprises (with Sample Language and Model Broker Registration Agreement)

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CONSIDER THIS common series of events: A leasing broker has a good potential tenant for a property. The broker calls the property owner. The property owner agrees that the prospective tenant might be a good fit. The prospective tenant is willing to pay the asking rent—or at least close enough to it to make the deal work for the property owner. Landlord and tenant reach a deal. A lease goes out. Comments come back. Technical or legal issues arise. Negotiations break down. The tenant goes away. Or maybe the owner decides to rent the space to someone else who offers more rent. Exactly what happened and why isn't quite clear. Each side has its own version of the facts. The broker thinks the landlord killed the deal.

Under facts like these, the broker may conceivably sue for a commission. The broker's claim could survive the landlord's motion for summary judgment. The court could very well rule that the broker did enough to support a commission claim, even without a signed lease, at least under some circumstances. Traditional brokerage law supports such a ruling. A broker can recover a commission if the broker did his or her job: procuring a ready, willing and able tenant willing to pay a price the landlord is willing to accept. The deal doesn't necessarily need to close—i.e., the tenant doesn't necessarily need to sign a lease—for the broker to claim a commission, at least if the broker can somehow argue the landlord prevented the deal from closing. A New York case decided in mid-2013, discussed later in this article, one of many similar cases over many decades, confirmed this traditional principle

of brokerage law in the context of leasing brokerage.[1]

As a common variation, in a hot market the owner of an attractive building often receives cold calls from brokers waving big numbers, offering highly credible buyers and otherwise trying to get the owner to sell. The owner might have a conversation with the broker and his client, and might even entertain a proposal. If those discussions break down, the broker might, again, still successfully claim the owner owes a commission, if the broker can show he delivered a "ready, willing, and able" buyer at a price satisfactory to the owner even if no formal written agreement ever existed. It's relatively easy for the broker to claim there "would have been" such an agreement if the owner hadn't decided to ditch the transaction.

Like so many ancient legal principles, these principles of brokerage law make no sense in today's world. Today, an owner intuitively expects not to have to pay a commission unless the broker's tenant or buyer actually creates value by signing a lease or closing an acquisition. An owner also knows that many things can go wrong, including a simple change of heart, between a deal in principle and a closing. If something does go wrong, no owner wants to have to prove why the broker didn't earn a commission. In this case, as in so many others, intuition is a poor guide to the law.

Stories like these call into question the common practice by which an owner enlists or at least accepts the help of brokers without negotiating or signing any brokerage documentation at all at the outset. Instead, if and when the parties reach an agreement in principle and seem to be moving toward documents, the owner expects to negotiate and sign a brokerage agreement as part of documenting the deal. Without some protective agreement earlier in the process, though, the owner could face the risk, not always theoretical, that negotiations will break down, but the broker will still claim a commission.

A cautious owner should consider a more deliberate process. If a broker is dangling desirable tenants, the owner should put in place some minimal agreement with the broker (just a mechanism to prevent claims) as early as possible in the process, and well before entering any negotiations. The same goes for a potential sale.

In the context of a lease, of course, if the owner has already engaged the broker as leasing agent for the building, then the agency agreement should cover the issue and forestall unexpected commission claims. These problems will occur more often in one-off transactions or if a new (or additional) broker gets involved, especially if the broker and owner don't expect to have a continuing relationship. Without a formal agreement, if the broker is "really" the tenant's broker, or isn't an institutional broker who wants a long-term relationship with the owner, problems can arise.

In the context of leasing brokerage, can an owner eliminate these risks by having a leasing agent for the building? Not really. Even then the risk remains. In the New York court decision mentioned earlier, the leasing agent conducted negotiations for the owner, but the court still thought the outside broker might have a good claim.

Similar problems might arise, in reverse, when a national retailer receives unsolicited inquiries from brokers proposing locations for the retailer's next store. Here, the retailer is the equivalent of the "owner" and therefore wants to avoid claims from a broker who helped negotiate a deal for a lease that the parties never actually sign. Even if the landlord would have paid the commission for a "done deal," a creative broker can claim that because it's the tenant's fault that the deal didn't close, the tenant should compensate the broker for the commission the broker would have collected from the landlord.

In any of these cases, the dynamics of the commercial brokerage business give a broker every in-

[1] *Optimal Spaces, Inc. v. 5 Hanover LLC,* 201 NY Slip Op 51171(U), July 12, 2013 (Sup Ct. N.Y. County).

centive to assert a premature claim. Most efforts to bring about most commercial transactions fail, so most of a broker's efforts will go to waste. In the occasional case where the broker achieves any degree of success, she may have hit the jackpot. Commercial brokerage relies on big hits rather than a steady stream of income from lots of small, easily arranged transactions. So a broker has every incentive to make a claim if any basis at all exists for doing so. Unfortunately for owners, the law allows such claims under circumstances that an owner would regard as premature.

An owner protection agreement needs to state only that the broker won't receive a commission unless the owner actually negotiates and closes a deal. Such an agreement, if entered into early in the process, need not lay out all the details of the commission or the entire relationship between owner and broker. The owner will just want to protect himself from legal arguments that might limit his ability to walk away from the transaction. The essence of such an agreement can be distilled into a paragraph, such as this, in a letter from the broker to the owner:

We look forward to discussing with you the possible interest of _____ ("Prospect") in a transaction involving _____. You will have no obligation or liability to us, we will not look to you for any payment, and you may terminate discussions at any time, unless and until you enter into and close a binding transaction with Prospect and all conditions to its effectiveness have been met or waived.

If an owner doesn't want to cover the matter in a separate letter with the broker, he can address the issue in the usual preliminary document that the parties exchange as they try to reach a nonbinding business deal, i.e., a term sheet or letter of intent. That document will usually already say something about the broker. Any party worried about exposure to premature brokerage claims might simply ask the broker who might make a claim to add language like this to the letter of intent or term sheet:

No party to this contemplated transaction shall have any liability for any payment to any broker, and each party may terminate discussions at any time without liability to any broker, unless and until the parties agree on, sign and exchange binding documents, all conditions to their effectiveness have been met or waived and a closing has occurred.

Either of these sample provisions just suggested, if the broker signs onto it, should prevent a broker from making premature claims. But each leaves a lot unsaid. One could add many other points to the understanding between the parties, inflating the agreement from a paragraph into a page or more. As always, legal documents of all types only get longer, never shorter. An example of a more complete preliminary agreement with a broker follows this article. That agreement goes into some other issues that an owner or broker might want to resolve early in the process, beyond just protecting the owner from premature commission claims.

If an owner wants to enter into an agreement like this, he should make that clear when the broker submits the first term sheet or other proposal. Nothing stops the owner from requiring it before that. If the owner doesn't want to have a complete, full-blown brokerage agreement at that point, that's fine. The owner just needs to assure that some binding documentation communicates one crucial point: the owner will never owe a commission unless a transaction actually closes. If and when a transaction actually starts to come together, it's up to the owner and the broker to proceed with the usual commission negotiations and sign a more complete agreement.

The model agreement following this article achieves two goals. First, it protects the owner from unexpected claims, something the owner could also achieve with the simpler language options suggested above. Second, this agreement recognizes the

broker as the procuring cause of a particular potential counterparty and takes care of some other housekeeping.

The first goal serves the owner, recognizing that brokers can and do assert claims even when their efforts do not bring about an actual transaction, as described earlier in this article.

Under this letter agreement, if and when the broker actually does earn a fee, the broker can either agree to look solely to its prospect, or acknowledge it has no claim against the owner absent a closing. If the broker acknowledges that it has no claim and a closing occurs, this model registration agreement (just like either of the shorter options suggested above) does not immunize the owner from claims. In fact, in that case—if a true closing occurs and the owner gets the benefit of a completed transaction—then the broker could still potentially assert a claim, even if the parties never actually signed a brokerage agreement. To prevent that, the parties must sign a brokerage agreement before or along with transaction documents, or at the very least before closing.

The second function of the preliminary agreement offered here benefits primarily the broker. A broker will worry that if the broker introduces the owner to a possible counterparty, then the owner might "go around" the broker and deal directly with the interested party. This concern often leads some brokers to ask owners to sign a marginally literate "noncircumvention agreement" very early in any negotiations. Because the broker's concern is understandable, this model agreement contains the essence of a noncircumvention agreement—though written in English, unlike most such agreements.

This agreement also requires the broker to "register" his client, and requires the owner to recognize that registration. Once that happens, the owner might sometimes already have a relationship with the broker's client, so the broker's introduction serves no purpose. One can handle this concern by adding language to give the owner the right to quickly disallow and "un-register" the broker's client by establishing that the owner already knew that person and was perhaps already having discussions with her. The model registration agreement offers optional language to that effect. If the owner wants to un-register the possible counterparty, then the owner bears the burden of showing some level of pre-existing relationship with or knowledge of that counterparty. The model requires proof of that relationship through email communications dated within a certain period before the registration agreement.

An owner might, of course, prefer to sign a full brokerage agreement now, in place of this letter or a one-paragraph waiver letter, leaving nothing for later. But that may be too much work, the transaction may never happen, the risks may seem manageable, this letter may already be too long, etc. (On the other hand, a full brokerage agreement is not much more difficult to negotiate than this letter and is probably more "standard.") Until the parties sign a full brokerage agreement for an imminent transaction, though, this letter protects the owner in some important ways. If and when the parties sign a brokerage agreement, it would supersede this letter.

Owners who ask brokers to sign agreements like the one offered here may encounter rough sailing. Brokers do not like signing this type of agreement. They may say it's premature. Many brokers don't like thinking too much about legal concerns or dealing with legal documents of any kind. They might say the model agreement following this article is "too long." They might be right about that, and if so perhaps they will agree to one of the much shorter options suggested earlier in this article. They may favor taking their chances, knowing that if the owner takes the bait, the law of brokerage may ultimately support a claim so the broker can hit the jackpot—exactly what this letter seeks to prevent.

As another possibility, once a broker sees this letter, a broker who claimed to have the ideal purchaser may announce that she doesn't want to bother with the property in any way unless she gets an exclusive listing, even though the broker premised their overture on the proposition that they had one ideal buyer for the property. This actually happens a lot. It shows that owners may end up wasting their time if they deal with one-off inquiries from brokers. In other words, the best way to deal with brokers may be to carefully choose one reputable broker and enter into an exclusive listing.

Of course, sometimes a broker who parachutes in with a "great buyer" may in fact: (a) have an actual great buyer who is willing to pay more than anyone else; and (b) not really be looking for an exclusive listing.

More often, though, in today's world, everyone knows everyone and everything. That makes it unlikely that a particular broker will add value by introducing the owner to a buyer that no one else could possibly have found. A broker instead will more often add value by developing the best possible marketing program to present the owner's property, determining which prospective buyers should learn about the property and when, and playing multiple buyers against each other to achieve the best possible execution. That type of a brokerage engagement requires the owner to choose a single exclusive and competent broker and then undertake a strategic marketing program with that broker's expert advice, rather than deal with a menagerie of one-off brokers.

The owner's dilemma—how to deal with all these brokers and brokerage alternatives—is not a bad problem to have. The owner also should remember that markets change. If the owner does in fact want to sell in a hot market, then he or she should not waste time. He or she should try to get a solid deal signed and closed before the market turns against him.

If an owner chooses to deal with multiple brokers, though, the exposures described in this article merit careful consideration. An owner doesn't need to do very much to protect herself. And the owner's lawyer can play a crucial protective role by encouraging the owner to sign an agreement based on this model—or at least have the broker sign a one-paragraph waiver of the type suggested here—before opening substantive deal discussions.

MODEL BROKER REGISTRATION AGREEMENT AND COMMISSION WAIVER

[Date]

CONFIDENTIAL

[Name and Address of Property Owner]

Registration of Prospect for _____ (the "Property")[2]

To the Owner:

[2] This assumes the owner owns the Property and may sell it. With adjustments, this letter will work for a landlord with vacant space who receives unsolicited inquiries from brokers, or a national tenant looking for new locations but also worrying about reaching a nonbinding agreement with an owner and then deciding not to proceed.

Please countersign below to confirm (the "Registration") that we: (a) may discuss the Property with _____ or its affiliate (the "Prospect"); (b) may seek to develop Prospect's interest in a possible ground lease, joint venture, recapitalization, redevelopment, sale, space lease or other transaction for the Property (any of these, a "Transaction"); (c) introduced Prospect to the Property; and (d) are Prospect's broker of record.

Notwithstanding anything in the previous paragraph, if you already [had a relationship and lines of communication] [discussed the Property or a possible Transaction] with Prospect, as demonstrated by email communications dated within the last ___ days, then the Registration shall be of no force or effect. You must, however, notify us of that in writing within ____ days of the date of this letter, or the Registration will remain fully effective.[3]

This Registration will remain in effect only for this "Registration Period": (a) ___ days after the date of this letter (the "Initial Period"); (b) if, in the Initial Period, we show the Property to Prospect and, with Prospect's approval, give you (by email or otherwise) a written letter of intent or term sheet for a Transaction (an "LOI"), then so long as you are actively negotiating an LOI or binding documents (the "Documents") with Prospect (the "Negotiation Period"); and (c) if you sign Documents in the Initial Period or the Negotiation Period, then until Closing as defined below.[4]

The Registration Period will also continue for ___ more days (the "Tail Period") after: (x) the Initial Period ends with no LOI or signed Documents; or (y) the Negotiation Period ends with no signed Documents or Closing. You or your counsel may, by email: (x) give notice of any Tail Period; or (y) extend the Registration Period.

In the Registration Period, you will not circumvent us in dealings with Prospect. After the Registration Period, we have no rights or claims regarding Prospect, but the rest of this letter still applies.[5]

Although you recognize our Registration, we initiated these discussions. You have made no determination to proceed with a Transaction on terms in an LOI or any other terms. The purpose of this Registration is just so you can see if it makes sense for you to even consider whether you have any interest in a possible Transaction. Your signing this Registration does not imply you plan to enter into a Transaction.[6]

You have no obligation to sign Documents or close a Transaction. You may freely and without liability to us, for any reason or no reason, or arbitrarily, capriciously or willfully: (a) withdraw the Property from the

[3] This paragraph is optional. If the parties think very hard about the issues raised here, then they may face a conundrum: which side will show their cards first? As a practical matter, they deal with it. And most but not all brokers and owners are honorable.

[4] To shorten and simplify this document, one could provide for, e.g., a 12-month Registration Period and call it a day, deleting this paragraph and the next two.

[5] If the broker already had a relationship with Prospect, and brought only one Prospect to the Property, and the owner didn't know the Prospect before, then the broker might reasonably demand perpetual exclusivity. A Tail Period after which "anything goes" may make more sense when an owner engages a broker for a broad marketing program.

[6] An owner would add this paragraph only if some other document gives a third party pre-emptive rights if the owner "decides to sell."

market or any possibility of a Transaction; (b) not sign Documents; (c) default[7] under any Document; (d) discontinue or not even start negotiations; (e) enter into a Transaction with someone other than Prospect; or (f) work with other brokers or finders, except regarding Prospect in the Registration Period. You may do any or all of these things even if you and Prospect reach an understanding on a Transaction but no Closing has occurred. In any of those cases, you will owe us nothing.

[We will look only to Prospect for any commission, compensation, or other consideration due us as a result of any Transaction or other dealings with Prospect.[8]] We will not look to you for payment of any kind, and you will have no liability to us under any circumstance[, except as follows. If signing of Documents seems imminent, then you and we will promptly and in good faith negotiate a commercially reasonable agreement on ordinary and customary terms for you to pay an agreed commission only if a Closing occurs (a "Brokerage Agreement"). A "Closing" means: you and Prospect sign and exchange Documents; any due diligence period or termination or rescission right lapses without exercise; all conditions to a Transaction closing are met or waived; you actually close a Transaction with Prospect; and you receive the consideration due at closing. If and only if a Closing occurs but you and we did not sign a Brokerage Agreement, then this letter, except its provisions on confidentiality, shall have no force or effect for any purpose, as if it had never been signed, and shall not bind or limit anyone in any way[9]].

You and we may exchange emails on the Property, the Prospect, a Transaction or Documents (the "Emails"). No Email and no oral communications will modify this letter, obligate anyone, extend the Registration Period or constitute a Brokerage Agreement (each, a "Modification"), except as this letter states. If an Email transmits as an attachment a Modification, manually signed with pen and ink, not an electronic signature, then that attachment binds the signer. Except as this letter states, any Emails will not: (a) be written with advice of counsel or intention of having legal effect; or (b) have legal effect or be admissible in court

We will keep confidential all information on this engagement, the Property, any Transaction and any Documents, except we can share it with Prospect and Prospect's advisors. We will direct them to preserve confidentiality. We may disclose this agreement in any dispute between us, but shall seek confidential treatment.

This letter applies only to Prospect. We will not list or publicize the Property, or suggest or communicate its possible availability, except to Prospect. We will not introduce anyone except Prospect to the Property. We will not purport to bind you to any Transaction. This arrangement is nonexclusive. We will not work, and have not worked, with any other broker, finder or other agent for the Property or a possible Transaction.

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[7] Brokers will often seek to have rights against an owner that "willfully defaults." An owner should resist that concept and insist on absolute freedom to default.

[8] Choose this bracketed language or the next bracketed language, but not both.

[9] Here, the broker could claim a commission and a court would decide its amount and timing. Neither owner nor broker should let this sentence govern. An owner might prefer to negate any commission under these circumstances. That seems unreasonable.

If Prospect comes to the Property in a group of investors or other participants, you will have no liability to us unless we affirmatively show you introduced Prospect to that group in the Registration Period, including a Tail Period.[10]

You confirm you have engaged no exclusive broker for a possible Transaction ("Exclusive Broker"). You have not committed to engage us as Exclusive Broker. If you engage an Exclusive Broker other than us in the Registration Period, then you will promptly notify us. When we receive that notice, the Registration Period will end. A Tail Period will then apply, but only if we affirmatively show you suggested Prospect to Exclusive Broker in that Tail Period.

If Prospect wishes to acquire the business located in the Property (the "Business"), then: (a) references to the Property also refer to the Business; (b) we acknowledge the Business is separately owned; and (c) references to you also refer to the Business owner.

When we say "you" in this letter, we also mean your constituent principals, partners, members, employees, agents, board members, family members, and other related parties.

We look forward to speaking with you about Prospect.
Very truly yours,

NAME OF BROKER

By: _____

Agreed.

NAME OF OWNER

By: _____

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[10] This paragraph and the next two cover situations that have arisen in the author's experience, but are candidates for early deletion.