

## **Broker Commissions: Put Them In Writing!** **By Dale Alberstone, Esq.**

Several years ago, I wrote an article for AOA Magazine discussing real estate broker commissions. I recommended then, and continue to encourage, that all commission agreements between real estate brokers and their clients be put in writing and signed by both the licensee and his or her principal. A written agreement is important for two reasons: First, it eliminates future misunderstanding between and forgetfulness of the parties. Second, a written agreement is legally enforceable, whereas a verbal commission agreement is not.

This month's column will review the important laws pertaining to real estate commissions and conclude with a comment concerning taxation.

### **Commissions**

As a general rule, a broker may not collect a commission from a seller (or buyer) unless there exists a written commission agreement signed by the broker's client. Among lawyers, that rule is known as the "Statute of Frauds" and is found in Civil Code Section 1624(a)(4). Although the broker need not also sign the agreement to enforce it against his/her client, it is prudent for the broker to do so anyway.

If a seller asks a broker to find him a buyer for certain property, and the broker then procures such a buyer, the broker cannot recover a commission unless the seller agreed in writing to pay one. Under the Statute of Frauds, oral agreements to pay a commission to a real estate broker are unenforceable whether made by a seller or a buyer. Only written agreements give rise to such liability. (See Phillips v. Shapell Industries, 43 C.3d 1247.)

The Statute of Frauds also bars a broker from recovering from the seller a "reasonable fee" for the broker's services unless there exists a written memorandum between the two.

However, there is a limited exception to the general rule, though seldom used, which may allow a broker to obtain a commission from either a buyer or a seller in the absence of a written agreement. This theory is known as "Interference with Prospective Economic Advantage" and is grounded in a concept of "tort" recovery rather than damages for breach of contract.

In Buckaloo v. Johnson 14 C.3d 815, a property owner placed a "For Sale" sign on her property which said "Contract your local broker." She did not give a listing to any specific broker, but the buyer's broker, upon seeing the sign, introduced the buyer to the seller in connection with the proposed purchase. The buyer then proceeded to buy the property from the seller. Both the buyer and the seller decided not to pay the buyer's broker a commission.

The buyer's broker then sued both the seller and the buyer for a commission under two theories, namely: breach of contract and interference with prospective economic advantage. The California Supreme Court held that the Statute of Frauds barred the broker from recovering on a breach of contract theory. However, the court explained that both the seller and the buyer might have liability in tort to the buyer's broker for interference with the broker's prospective advantage of receiving a commission.

The court held that the broker could recover an amount equivalent to the alleged commission, plus punitive damages, if five elements are present: (1) an economic relationship existed between the broker and the seller or the broker and the buyer concerning the probability of future economic benefit to the broker; (2) the parties being sued knew of the existence of that relationship; (3) the parties being sued intentionally acted to disrupt that relationship; (4) the relationship with the broker was actually interrupted; and (5) the broker failed to receive his commission.

These elements may seem confusing, but they can be simplified in concept. Assume that the seller of an apartment places an ad in the newspaper looking for a buyer. Assume further that a broker calls the seller and tells him that he has a potential buyer for the property. Thereafter, the seller gives the broker permission to show the various apartment units to his buyer. Since the buyer now knows the identity of the seller, assume that the buyer and seller conspire to complete an escrow transaction without recognizing or honoring the broker's claim to a commission.

The broker cannot then sue either the buyer or seller for a commission under a breach of contract theory (because nothing is in writing). But under the doctrine of interference with

prospective economic advantage, the broker can claim that the parties knowingly interfered in their own relationship with him under circumstances where all parties were aware that the broker was rendering services in exchange for payment of a commission. Under such a scenario, both the buyer and seller may have liability to the broker for damages in an amount equal to the claimed commission.

The lesson to be learned is that the absence of a written agreement with a broker does not mean that the broker cannot ever recover a fee for his services. If the facts meet the five elements set forth above, the broker could prevail in the litigation. Nevertheless, it is always wise for brokers and their sellers (and sometimes their buyers) to sign a written agreement so that both parties can determine their rights and obligations without having to resort to litigation.

Having a written agreement also eliminates future misunderstandings between broker and his client. For example, many listing agreements provide that a broker earns his commission if he produces a buyer who is "ready, willing and able" to purchase the property without regard to whether the escrow ultimately closes. Some cases in California hold that if a buyer is financially able to purchase the property, the broker earns the commission even if the buyer withdraws from the transaction just prior to the close of escrow. The theory is that the buyer was ready, willing and able at the time he signed the purchase contract and, therefore, the broker performed his services under the written agreement and is entitled to be paid. The cases further explain that the seller's remedy is to pursue (or sue) the buyer for breach of contract after the seller pays the broker's commission.

Many brokers will release the seller from having to pay a commission under circumstances where the buyer improperly withdraws from the purchase agreement. However in order to avoid uncertainty over this, as well as other fee disputes, it is wise that the parties (particularly the seller) read the listing agreement before signing it.

## **Tax Advice**

On a different matter, California law holds that a broker does not ordinarily have a duty to advise his client of the tax consequences of a property transaction.

In Carleton v. Tortosa (14 C.A.4<sup>th</sup> 745), a seller retained a broker to sell his two residential properties. In the listing agreement, it was stated that "A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional." The purchase contract also informed the seller that "A real estate broker or agent is qualified to advise on real estate. If you desire legal or tax advice, consult your attorney or accountant.

After the transaction was completed, the seller's accountant informed him that he had incurred a tax liability of \$34,000 on the transactions because they were not properly structured as tax-deferred exchanges. The seller then sued the broker for professional negligence, alleging that he failed to warn him of the adverse tax consequences and failed to structure the transactions as tax-deferred exchanges.

The court held that a broker is not liable for failing to give proper tax advice if the listing agreement or the purchase contract states that the broker is not offering any tax advice and that the seller should confer with his own consultant.

The bottom line is that sellers (as well as buyers) of apartment buildings should always check with their accountant or tax attorney prior to entering into a transaction. Brokers are qualified to negotiate the sale of apartment buildings, but they should not be relied on to give advice about the tax implications of a transaction.

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