

AUBURN MLS MEETING MEMO

To: Auburn Brokers/Title Officers/Lenders
From: Brigit S. Barnes, Brigit S. Barnes & Associates, Inc.
Subject:
Date: September 2, 2010

HEADLINE: PURCHASE AND SALE AGREEMENTS;**Broker Commissions;Broker** Entitled to **Commission** when Buyer Entered into Buy-Sell Agreement;RC Royal Development and Realty Corp. v. Standard Pacific Corp. No. B206894, 2d Dist., Div. 32009 Cal. App. LEXIS 1606September 29, 2009 (cert. for part. pub.)

AUTHOR:

HIGHLIGHT: Under the buyer's agency agreement with its **broker**, the buyer's entry into a purchase agreement with the seller of real property triggered an obligation to pay the **broker's commission**. Close of escrow was not a condition precedent to the right to a **commission**.

BODY:

Plaintiff, a licensed California real estate **broker** ("RC"), notified defendant Standard Pacific that it had information about a condominium development project in Los Angeles County. In June 2005, Standard Pacific entered into a written "Confidentiality and Agency Agreement" with RC designating RC as its agent with respect to information or offers concerning that or other property (the Agency Agreement). Under the Agency Agreement, Standard Pacific agreed to pay RC a brokerage **commission** equaling 1.5 percent of the gross sales price for the property. RC allegedly brought Standard Pacific two parcels of real property owned by LPC Union Apartments, L.P. (Lincoln), located in downtown Los Angeles.

On August 19, 2005, Standard Pacific entered into a "Real Estate Agreement" with Lincoln to purchase the property for \$116 million (the buy-sell agreement). Under that agreement, Lincoln agreed to improve the property by developing two separate buildings containing 107 and 171 condominium units, with subterranean parking and related facilities. Also on August 19, 2005, Standard Pacific and Lincoln opened escrow on the property. Concurrently with the opening of escrow, Standard Pacific paid a \$1 million deposit, and then \$5 million as earnest money before September 14, 2005.

In the buy-sell contract, Standard Pacific agreed in part that its obligation to close was subject to the satisfaction or waiver of a "review period" that expired on September 14, 2005. Lincoln agreed to provide title and construction documents for Standard Pacific's inspection and evaluation. Standard Pacific could terminate the buy-sell contract during

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the review period without forfeiting its earnest money, but its failure to terminate the buy-sell contract by September 14, 2005, would constitute a conclusive waiver of the conditions contained in the review period.

The buy-sell contract also conditioned Standard Pacific's obligation to purchase the property on the issuance of a temporary certificate of occupancy for phases 1 and 2, the recordation of a final map, and the delivery of the architect's certificate. The buy-sell contract contemplated that the transaction would close within five business days of the issuance of a temporary certificate of occupancy "but in no event earlier than January 4, 2006." The buy-sell contract did not provide that time was of the essence.

The temporary certificate of occupancy was never issued. A vice-president of development for the Los Angeles division of Standard Pacific (Colton) declared in connection with Standard Pacific's summary adjudication motion that as of August 2006, occupancy permits had not been obtained and there was no certainty about when the project would be completed or when escrow would close. The vice president of land acquisition of the Los Angeles division of Standard Pacific (Call) declared that the project had encountered delays in permitting, inspection, and construction. The declarants averred that during the period of delay, the condominium market in downtown Los Angeles suffered a reversal with the result that Standard Pacific felt its purchase of the property as a condominium project was no longer economically feasible or beneficial. Escrow never closed and Standard Pacific never acquired the property.

In August 2006, Standard Pacific and Lincoln entered into a release and settlement agreement terminating the buy-sell contract and escrow. Thereunder, Standard Pacific forfeited \$4 million, representing its earnest money minus \$2 million it spent in investigation and transaction costs on the project. Standard Pacific did not pay RC its **commission**.

RC brought this action against Standard Pacific seeking damages under theories including breach of contract and breach of the implied covenant of good faith and fair dealing. The gravamen of RC's complaint was that its right to the **commission** under the Agency Agreement had vested and Standard Pacific was not justified in declining to finalize its purchase of the property. RC alleged that Standard Pacific breached the Agency Agreement by "failing and refusing" to pay RC its **commission**, and breached the implied covenant of good faith and fair dealing "by failing and refusing to complete" the buy-sell contract without justification or cause.

Standard Pacific moved for summary adjudication on the basis that RC had no basis for recovery of a brokerage **commission** because Standard Pacific never breached any obligation it owed to RC. Alternatively, Standard Pacific sought summary adjudication of the breach of contract cause of action on the grounds that the Agency Agreement provided that a **commission** would be earned only when Standard Pacific's purchase of property "actually closes." Standard Pacific sought summary adjudication of the cause of

action alleging breach of the implied covenant on the grounds that it acted with justification and in a commercially reasonable manner at all times.

The trial court granted Standard Pacific's summary adjudication motion. The trial court interpreted the Agency Agreement to provide that Standard Pacific would have obtained an interest in the property sufficient to trigger its obligation to pay RC's **commission** only when "all contingencies and conditions have been removed," which the court found had not occurred. The court ruled that the close of escrow was a condition precedent to Standard Pacific's obligation to pay RC its **commission**. Because escrow never closed, no **commission** was due. The court found that Lincoln's inability to timely deliver a finished project caused the project to drag on. During that time, the Los Angeles market deteriorated, making the project uneconomic and justifying Standard Pacific's decision to terminate the buy-sell contract as a matter of law. As a result, the trial court found that Standard Pacific did not breach the implied covenant of good faith and fair dealing. RC appealed from the judgment entered for Standard Pacific. The court of appeal reversed, in a decision certified for partial publication. In the published portion of the decision, the court held that the trial court erred in granting summary adjudication on the cause of action for breach of contract. In the unpublished portions of the decision, the court rejected RC's challenges to evidentiary rulings and held that triable issues of fact about whether the buyer had cause or acted in bad faith in failing to close escrow precluded summary adjudication of the second cause of action.

Breach of Contract. The court held that the trial court erred in granting summary adjudication of the first cause of action for breach of contract because Standard Pacific's obligation to pay RC's **commission** became fixed at the time it entered into the buy-sell contract with Lincoln, not at the time escrow closed. The court quoted section 2 of the Agency Agreement: Standard Pacific and RC "agree that RC shall be entitled to receive a brokerage **commission**, to be paid by [Standard Pacific], ... as compensation for services, in the event that the Property is purchased by [Standard Pacific] or an affiliate of [Standard Pacific] within one (1) year of the date of this Agreement. As used herein 'Purchase' shall mean and include any and all acquisitions of any direct or indirect beneficial interest in the Property, including, without limitation, any lease, option, finance, exchange, stock purchase, joint venture or other transaction through which [Standard Pacific] would acquire a direct or indirect beneficial interest in the Property. The **commission** shall be paid to RC by [Standard Pacific] through escrow at closing. [Standard Pacific] and RC further agree that [Standard Pacific] shall include and incorporate a brokerage **commission** provision in every letter of intent, purchase contract and escrow instructions indicating the amount of the brokerage **commission** (1.5% of the gross sales price) payable to RC by [Standard Pacific] as compensation for services. [Standard Pacific] hereby specifically authorizes RC to make a demand for payment of its **commission**/fee earned hereunder to any escrow or other party affecting the transfer of the Property. [Standard Pacific] shall instruct such escrow, and shall cause [Lincoln] to similarly instruct such escrow, to withhold from the gross sales proceeds from the sale of the Property an amount sufficient to pay all **commission**/fee earned by RC hereunder."

RC argued that it was entitled to its **commission** when the property was "purchased" by Standard Pacific, which was defined in the Agency Agreement as "any and all acquisitions of any direct or indirect beneficial interest in the Property... ." RC argued that once Standard Pacific entered into the buy-sell contract, it obtained a "direct or indirect beneficial interest" in the property with the result that RC earned its **commission**. Standard Pacific argued that it was not obligated to pay any **commission** because escrow never closed and therefore it never acquired any "beneficial interest" in the property.

The court noted that the interpretation of a written instrument is solely a judicial function unless the interpretation turns upon the credibility of extrinsic evidence. It further noted that the reviewing court is not "bound by a construction of the contract based solely upon the terms of the written instrument without the aid of evidence, where there is no conflict in the evidence, or a determination has been made upon incompetent evidence" [*Parsons v. Bristol Development Co.* [(1965) 62 Cal.2d 861, 44 Cal. Rptr. 767]]. The court stated that because the Agency Agreement was written and its meaning did not turn on extrinsic evidence, construction of the agreement was a matter of law for independent determination by the court.

The court further noted that "a real estate brokerage contract is a contract for employment of an agent, and the relationship is governed by both agency and contract law," quoting 2 Miller & Starr, Cal. Real Estate, § 5:18. The court stated that although certain terms are required for a brokerage employment agreement, "the parties are entitled to make the **broker's** employment and his right to compensation depend upon any lawful condition that they agree to insert in the agreement," such as the close of escrow or upon receipt of funds by the seller from an escrow, citing *Steve Schmidt & Co. v. Berry* [(1986) 183 Cal. App. 3d 1299, 228 Cal. Rptr. 689 and *R. J. Kuhl Corp. v. Sullivan* [(1993) 13 Cal. App. 4th 1589, 17 Cal. Rptr. 2d 425].

The court next noted that "while brokerage contracts are typically executed between the seller and **broker**, the same rules apply when the buyer employs a **broker** to find particular property and negotiate a purchase on specified terms; i.e., the contract may make the buyer's duty to pay a **commission** contingent on the satisfaction of any lawful conditions ... ordinarily, (1) the buyer's entry into a binding contract for purchase, and/or (2) actual consummation of the purchase" [Greenwald & Asimow, Cal. Practice Guide: Real Property Transactions (The Rutter Group 2008) § 2:305, citing *R. J. Kuhl, above*]. Thus, the court stated that generally, in a buyer-**broker** agreement--under which the principal employs a **broker** to find and negotiate a purchase of real estate--"unless the contract provides otherwise, the **broker** earns his **commission** upon the principal's entry into a binding contract for a purchase subject to the brokerage contract regardless whether the sale is consummated," citing *R. J. Kuhl*.

The court stated that, construing the Agency Agreement according to the usual rules of contract interpretation, section 2 of the Agency Agreement defined when RC's right to

the **commission** would arise. The court stated that although section 2 provided that "RC shall be entitled to receive a brokerage **commission** ... in the event that the Property is purchased by [Standard Pacific]," "purchase" was specifically defined as "any and all acquisitions of any direct or indirect beneficial interest in the Property," and the section continued with an incomplete list of examples. The court concluded that this provision describing the conditions for the **commission** specified that RC would earn its **commission** when Standard Pacific acquired a "direct or indirect beneficial interest" in the property.

The court stated that a "beneficial interest" is a "profit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership," quoting Black's Law Dict. (6th ed. 1990). The court stated that generally, in the context of real estate transactions, a purchaser "acquires, except against interests prior in right, a conditional, equitable title to the property in fee simple" on the execution of an agreement for the purchase and sale, quoting 54 Cal.Jur.3d (2008) Real Estate--Contracts for Sale, § 108. The court also cited *Osborn v. Osborn* [(1954) 42 Cal.2d 358, 267 P.2d 333 ("at the time of the execution of the contract of sale, the grantee acquires an equitable title to the estate being sold; the grantor retains the legal title as security for the purchase price. The legal title passes to the grantee at the time of his completion of the conditions precedent")]; *Tucker v. Lassen Sav. & Loan Assn.* [(1974) 12 Cal.3d 629, 116 Cal. Rptr. 633]; *Hunt v. Inner Harbor Land Co.* [(1923) 61 Cal. App. 271, 214 P. 998]; and *Alhambra Redevelopment Agency v. Transamerica Financial Services* [(1989) 212 Cal. App. 3d 1370, 261 Cal. Rptr. 248 (stating rule that "a purchaser of real property under a land sales contract is considered an equitable owner of the property and is vested with the right to any condemnation award" where the property was taken after the purchase and sale agreement was executed)]. The court thus concluded that equitable title is a "beneficial interest," as it is one stick in the bundle of full legal rights to real property. The court stated that once Standard Pacific entered into the buy-sell contract containing all of the essential terms of purchase, it obtained equitable title and had a "beneficial interest" in the property, and RC earned its **commission**.

The court stated that although a mere executory buy-sell contract was sufficient to confer a "beneficial interest" on Standard Pacific in this case, its conclusion is bolstered by the undisputed facts showing that Standard Pacific went further than to execute the buy-sell contract. Standard Pacific paid \$1 million with the opening of escrow and \$5 million as earnest money, and it waived its right to terminate the buy-sell contract without forfeiting its earnest money because it did not terminate the agreement during the review period. The court noted that Standard Pacific even entered into purchase contracts with prospective buyers of units on the property. The court stated that because Standard Pacific partially performed its obligations under the buy-sell contract, it acquired not only equitable title but it also obtained a clear advantage resulting from the buy-sell contract and hence a "beneficial interest." The court thus stated that Standard Pacific could not persuasively argue it did not have a binding contract that gave it a beneficial interest in the property pursuant to section 2 of the Agency Agreement. As a result, the court held

that RC earned its brokerage **commission** on August 19, 2005, when Standard Pacific and Lincoln executed the buy-sell contract.

Close of Escrow Not a Condition Precedent to Obligation to Pay Commission. The court next held that close of escrow was not a condition precedent to Standard Pacific's obligation to pay RC the **commission**. The court noted that Standard Pacific read sections 2 and 3 of the Agency Agreement together to argue that its obligation to pay RC's **commission** was conditioned on the close of escrow, and because escrow did not close, the duty to pay the **commission** never arose. The court stated that this issue was addressed in *Steve Schmidt & Co. v. Berry*, above, in which the defendant-seller entered into a listing contract with the plaintiff-**broker**. The seller contended that the obligation to pay the brokerage **commission** was conditioned on the closing of escrow. The relevant portion of the listing agreement stated that the owner would pay a **commission** to the agent "in full at the close of escrow, whether or not said escrow closes within the term of this Agreement." The court of appeal agreed with the **broker** that the quoted language did not set forth the condition for entitlement to a **commission** but a limitation on the time of payment. It explained that "the obligation to pay the **commission**, as distinguished from the timing of the payment, became fixed at the time a ready, willing and able buyer was produced. Referring to the sequence of provisions in the agreement, immediately after fixing the terms of the agent's obligation (§ 3 of the listing agreement), the term of the authorization (§ 4) and the owner's obligation to accept an offer from a ready, willing and able buyer (§ 5 of the listing agreement), section 6 provides for the time of payment of the **commission**, that is, 'at the close of escrow.' ... 'The promise to pay was not contingent on the escrow's closing.' ... [P] Thus, we conclude that the failure of the escrow to close does not preclude Schmidt & Co. from collecting its **commission**."

The court noted that here, the second half of section 2 provided that "The **commission** shall be paid to RC by [Standard Pacific] through escrow at closing." Section 2 then required that Standard Pacific include a brokerage **commission** provision in the letter of intent, purchase contract and escrow instructions, and instruct escrow to withhold from the gross sales proceeds from the sale of the property an amount sufficient to pay all **commissions/fee** earned by RC. Section 3 of the Agency Agreement provided, "If the term of this Agreement ends at a time during which a written contract or negotiations exist between the Owner of the Property and [Standard Pacific] or any affiliate to purchase the Property and such purchase actually closes, the term of this Agreement shall be deemed to be extended to include the date of the closing of such purchase and sale."

The court stated that the references to escrow in section 2 of the Agency Agreement described the timing of payment of the **commission**, not a condition precedent to the earning of that **commission**. It stated that section 2 of the Agency Agreement was the provision governing the **commission**; the first half of section 2 established the circumstances under which RC's brokerage **commission** would be earned and the second half then fixed the time and manner in which Standard Pacific would pay the **commission**. The court stated that nothing in the second portion of section 2 conditioned

the obligation to pay the **commission** on the close of escrow, Standard Pacific's contention to the contrary notwithstanding. The court stated that section 2 contained no words indicating that escrow had to close before the **commission** is earned. For example, the court stated that section 2 did not provide "In the event of consummation of the sale of the property hereinabove referred to, party of second part is to be entitled to a **commission**," citing *Cochran v. Ellsworth* [(1954) 126 Cal. App. 2d 429, 272 P.2d 904]. The court observed that two of the Agency Agreement's examples of a "purchase," i.e., a "direct or indirect beneficial interest in the Property" such as would give rise to the obligation to pay a **commission**, were a lease and a stock purchase. The court pointed out that an escrow is not required in leasing or in stock purchases. It concluded that the Agency Agreement could not possibly contemplate that close of escrow be a condition precedent to the obligation to pay the **commission** when in at least two scenarios escrow would not even exist.

The court stated that section 3 merely explained the conditions under which the term of the Agency Agreement would be deemed extended; it did not condition the right to a **commission** on actual closing. The court stated that if "actual closing" had been the intent, then the parties should have used the "actual closing" language in section 2.

The court concluded that because the Agency Agreement did not provide otherwise, RC earned its **commission** when Standard Pacific entered into the buy-sell contract subject to the Agency Agreement, irrespective of whether the sale was consummated. Accordingly, the trial court erred in granting Standard Pacific's motion for summary adjudication of the breach of contract cause of action.

**Commentary on *RC Royal Development & Realty Corp. v. Standard Pacific Corp.*
By William M. Hensley Adorno Yoss Alvarado & Smith, Santa Ana, CA**

This decision is must reading for any developer contracting with a **broker**, whether as seller or buyer, with respect to how the agency agreement needs to be structured in order to avoid exposure for a **commission** where contractual contingencies fail or escrow fails due to no fault of the developer.

In this particular case, the **broker** obviously prepared the agency agreement that was very broadly worded, triggering a **commission** whenever a purchase occurred--but not figuring in for any failed contingencies or purchase defaults outside the control of the developer. The Court of Appeal correctly applied the "default rule" of *R.J. Kuhl Corp.*, which makes a **commission** depend on an actual purchase agreement rather than ultimate consummation of the sale agreement. That meant unexpected exposure for the developer when escrow never closed, mainly due to failed contingencies or events that appeared to be outside the control of the developer.

Obviously, freedom of contracting allows the parties to hinge a **commission** on much more--that is why this decision is must reading on the "what more" that needs to be

included in the agency agreement between seller/buyer and **broker**. The "what more," at a minimum, will tie a **commission** to consummation of a purchase agreement only if contingencies are not satisfied (through no fault of the contracting seller/buyer).

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