

Unpaid Brokers Get a Stronger Remedy

BY ERIC C. RUBENSTEIN

SECTION 294-b of the New York State Real Property Law, enacted in 1982, has been a seldom utilized tool for New York brokers seeking payment of commissions. This is likely to change now that an amendment, signed into law on Aug. 8, 2008, and effective the first of this year, gives expanded rights to brokers, including requiring that the unpaid amount of a commission or the net proceeds of the sale, whichever is less, be deposited with the recording officer until the claims have been decided in court.

While the new remedies presently apply only to residential transactions, it is quite possible that they will extend to commercial deals in the future. Therefore, brokers who are involved in commercial real estate transactions should pay keen attention to the new law, as it (or a form of it) may well apply to them in the not-too-distant future.

Section 294-b, Past and Present

The former version of the statute did not provide many teeth for a broker who was not paid its commission at closing. The broker was merely permitted to file an affidavit of entitlement with the recording officer itemizing the amount of the commission claimed. Section 294-b expressly stated that recording the affidavit did not invalidate the transfer of property and did not create a lien.

Amended 294-b, now effective, expands brokers' rights as follows:

(i) The affidavit of entitlement is now applicable to the sale of a cooperative unit.

(ii) Although the affidavit of entitlement is still not a lien, it will be recorded in a "lien docket" so that judgment and lien searches by purchasers and lenders will uncover the affidavit of entitlement where previously, it may not have been discovered.

(iii) If the broker's commission is not paid at closing, the seller must deposit with the recording officer an amount equal to the lesser of the unpaid portion of the commission or the net proceeds of the sale.

(iv) In any action where a court finds that the broker is entitled to compensation pursuant to the written contract of brokerage employment, the broker is awarded costs and reasonable attorney's fees (no such clause in favor of the seller appears in the statute).

One can imagine the turmoil created at the closing table on the sale of a trophy residential property, where the disputed commission could reach seven figures. That amount would not be delivered to the seller under the new



law, but would be held by the county clerk until the claim is resolved. If extended to the commercial arena, where brokerage commissions could be substantially higher, a seller needing to utilize all of the sale proceeds (perhaps for a 1031 exchange deal or other time-sensitive reason) would be denied the immediate use of the disputed amount indefinitely.

While brokers' remedies have been broadened, certain conditions must be satisfied:

(a) There must be a written brokerage contract containing the following statement in clear and conspicuous bold face type: "At the time of closing, you [seller] may be required to deposit the broker's commission with the county clerk in the event that you do not pay the broker his and her commission as set forth herein. Your obligation to deposit the broker's commission with the county clerk may be waived by the broker."

(b) There are strict time limits by which brokers must notify sellers of their claims and bring an action or the brokers' rights are forfeited.

Additionally, while brokers can essentially tie up the funds in governmental hands (where previously those funds would have gone directly to the sellers), the closing will not be prevented or delayed. Under the new statute the county clerk must note on the affidavit of entitlement that it does not constitute a lien and it does not invalidate any transfer or lease.

A key element in favor of sellers is the requirement that the written contract of brokerage employment must provide the critical language in (a) above in clear and conspicuous bold face type. While sellers will avoid signing brokerage agreements which contain this language, the relative leverage of the seller and the broker (particularly in this distressed market) may result in the clause being included. The larger, institutional brokerage companies may well include this language in their standard form.

While the amended 294-b now only applies, as noted above, to residential properties, proponents of the expansion of brokers' remedies are expected to press forward to try to extend the law to commercial real estate. In any event, it is very likely that we will see more affidavits of entitlement being filed under §294-b now, and real estate professionals need to be aware of the statute's potential impact on transactions.

ERIC C. RUBENSTEIN is a partner at Ruskin Moscou Faltischek, where he is co-chair of the firm's real estate department. He can be reached at 516-663-6513 or erubenstein@rmfpc.com.