



NJ Case of the Month:

Pagano Company v. 48 South Franklin Turnpike (A-9-08) (decided March 9, 2009)

By Alexander M. Wixted

A commercial real estate transaction often contains seemingly benign issues that, upon further examination, can have unforeseen financial implications for one or more parties. In a recent decision in *Pagano Company v. 48 South Franklin Turnpike*, the New Jersey Supreme Court held that the purchaser of a commercial property may be liable for the payment of a broker's commission that was due under leases assumed by the purchaser pursuant to a general assignment executed at closing.

In *Pagano*, the Supreme Court applied its prior holding in *VRG Corp. v. GKN Realty Corp.*, 135 N.J. 539 (1994), which held that to incur liability by virtue of an assignment the purchaser must have "affirmatively assumed" the seller's obligations to pay the commissions, to require that a purchaser honor a commission agreement absent a separate, express agreement to pay such commissions.

The plaintiff, *Pagano Company* (*Pagano*), is a licensed real estate broker. In 1997, *Pagano* and *Heritage III Office Center* (*Heritage*), the owner of a commercial property, entered into a written brokerage agreement that granted *Pagano* the exclusive right to procure tenants to lease space at the property. *Pagano* would earn commissions based upon rents received under any leases entered into by way of *Pagano's* efforts. The brokerage agreement included a provision that the agreement would be binding upon the *Heritage's* heirs, successors and assigns.

In 2004, *Heritage* entered into an agreement of sale with *48 South Franklin Turnpike, LLC* (*Franklin*) for sale of the commercial property. The agreement of sale contained a due diligence investigation provision that granted *Franklin* the right to inspect the records and books relative to the property, including copies of all leases then in effect. All of the leases governing the tenants in possessions provided that such tenants were procured and brokered by *Pagano* and expressly indicated that commissions would be due and payable to *Pagano*. Furthermore, the lease agreements also stated that if the commercial property was sold, the landlord would be released from the obligations under the lease and the acquiring purchaser would assume and carry out the landlord's obligations.

Franklin ultimately acquired title to the property. At closing, *Heritage* assigned to *Franklin* all of the leases for the existing tenancies at the property under a general assignment of leases and rents document, whereby *Franklin* agreed to assume and perform *Heritage's* obligation under the leases. The assignment document indicated that "assignor hereby assigns to assignee all of the assignor's right, title and interest in and to...any and all leases, tenancies, licenses, rental agreements, occupancy agreements and other agreements of whatever form now or hereafter affecting all or any part of the Property..." Following the closing, *Franklin* failed to pay commissions to *Pagano* for rents received under the assumed leases, and *Pagano* filed a lawsuit against *Franklin* to recover the outstanding commissions due.

The trial court ruled in favor of Pagano, citing the fact that Franklin had the opportunity to inspect the leases during due diligence but declined to raise an issue with the assignment language in the leases. Because each of the leases included a provision that in the event of the sale of the building the purchaser would assume and carry out all of the covenants and obligations of the landlord, the trial court reasoned that Franklin had affirmatively assumed the obligation to pay Pagano's commissions.

On appeal, the Appellate Division reversed the trial court's decision, relying on *VRG* but interpreting that decision in an alternative matter. The Appellate Division held that because "[n]owhere in the contract, closing documents, assignment or indeed in any other document did [Franklin] make a promise to either Heritage or Pagano to pay commissions to Pagano," Franklin did not affirmatively assume an obligation to pay any commissions.

The Supreme Court declined to follow the Appellate Division's "crabbed interpretation" of the broker provision in the leases. Instead, the Court revisited the *VRG* decision and held that a fair reading of *VRG* leads to the conclusion that the affirmative assumption of an obligation to pay a broker's commission can take many forms. According to the Court, "obviously an express promise by the assignee to satisfy the commission obligation is one of those forms." But, it is not the only one. Rather, where a purchaser executes a general assignment of leases that includes or refers to the obligation to pay commissions, he or she may be considered to have affirmatively assumed that obligation.

Turning to the underlying facts, the Court's holding highlighted the fundamental difference between the leases in *VRG* and the leases in this case. In *VRG*, the broker was unable to demonstrate that the purchaser had affirmatively assumed the seller's obligation as there was no express reference in the leases. To the contrary, in this instance each assigned lease contained an express acknowledgement that Pagano had played a role in leasing the premises and was due a commission by a separate agreement. The Court noted that Franklin, as a sophisticated purchaser of the commercial property, had an opportunity to inspect the leases and further had an opportunity to raise any questions or issues with the seller.

The dissenting justices proffered that an affirmative assumption as required under *VRG* should be clear and unequivocal to impose liability, and found insufficient evidence in the record of this case to hold Franklin liable for the commissions.

The *Pagano* decision illustrates the importance of conducting thorough due diligence. The sale of commercial real estate, or any real estate for that matter, is a fluid process that requires diligence from start to finish. Careful drafting of the assignment of leases and rents and the diligent inspection of documents will greatly aid the buyer in its endeavor.

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