Recent Appellate Division Decisions:
A Buyer's Breach, a Seller's Breach and a Broker Who Doesn't Get Paid

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Recently the Appellate Division issued several decisions concerning real estate transactions which failed to close and in which buyers, sellers and brokers were negatively affected by provisions in each of the relevant contracts. The cases below all point out the importance of strictly abiding by provisions of a contract that governs the relationships between buyer and seller, as well as the broker.

1. Gorgoglione v. Gillenson

The Appellate Division, First Department, decided this case on January 15, 2008. In its decision the Appellate Division reversed the decision issued by the Supreme Court in New York County.

A. The Facts of Gorgoglione

The plaintiff, Gorgoglione, and the defendant, Gillenson, entered into a contract of sale for defendant's cooperative apartment for $850,000.00. As is customary, the buyer paid a downpayment in the amount of $85,000.00 in connection with the transaction. The downpayment was held in escrow by the Seller's attorney pending the Closing. In all transactions involving the sale of a cooperative apartment, as in this one, a buyer must be approved by the Cooperative Corporation's Board of Directors (the "Co-op") and a seller must obtain the consent of the Co-op before any closing may take place.

The **Gorgoglione** contract provided for the customary "mortgage contingency" clause which required that the buyer obtain a mortgage commitment letter from a lender for a loan amount of $425,000.00 by a specified date, which in this case was January 25, 2005. The buyer obtained a mortgage commitment for the $425,000.00 amount and rejected it. The buyer applied for a higher loan amount of $552,000.00. It is important to note that both loan amounts were below the customary eighty (80%) percent loan-to-value ("LTV") ratio, which is the maximum threshold LTV permitted by the Co-op. The buyer, before the January 25th date, was able to obtain a mortgage commitment for the higher amount. Unfortunately, the Co-op soon thereafter rejected the buyer's application and denied the buyer's request for its consent.

The buyer immediately gave notice to the seller that he was canceling the contract due to the Co-op's denial. In accordance with the contract the buyer requested the return of the downpayment. The seller's attorney refused to return the downpayment. The seller's attorney notified the buyer that it was entitled to retain the downpayment on the grounds that the buyer breached the mortgage contingency clause, in that the buyer proceeded to obtain a loan for an amount higher than that which was permitted in the contract, and as a result was in default of the contract. The buyer then commenced an action against the seller for the return of the downpayment.

B. The Lower Court's Decision

The buyer and seller each made a motion for summary judgment against the other. The lower court granted the seller's motion for summary judgment entitling the seller to retain the downpayment as liquidated damages and denied the buyer's motion for summary judgment requesting return of the deposit. The trial court decided that since the buyer had obtained a non-conforming commitment letter she was in breach of the contract. The court decided that the seller could retain the downpayment.

C. The Appellate Court's Reversal and Rationale

In reversing the lower court's decision, the Appellate Division pointed out that the seller failed to provide any proof or evidence that the Cooperative Corporation rejected the buyer's application because of the higher loan amount and non-conforming mortgage commitment. The Court held that:

> [w]here a purchaser applies for financing on terms different from those contemplated by the financing contingency clause in the contract of sale, but the transaction fails for reasons unrelated to the financing terms for which the purchaser applied, the financing terms applied for are not deemed to have put the purchaser in breach of his or her obligation to make a good faith effort to obtain financing, and, assuming all other obligations have been fulfilled, the purchaser is entitled to the return of any deposit (citations omitted).

The Appellate Division reasoned that since the contract was conditioned upon the Co-op's consent and approval, which was ultimately not obtained, and since the Co-op's rejection was not based on the non-conforming loan commitment, the seller could not use the non-conforming mortgage commitment as a basis for keeping the buyer's deposit. The Appellate Division reversed the Supreme Court's decision which held that since the buyer did not follow the exact provisions of the contract by obtaining a non-conforming mortgage commitment (i.e. for the higher amount) the buyer was not entitled to the return of the deposit.

The Appellate Division explained that the contract contained an express provision which allowed both the seller and buyer the right to cancel the contract if (i) a mortgage commitment was unable to be obtained or (ii) the buyer obtained a non-conforming mortgage commitment. In this case, the Court pointed out that neither party elected to terminate the contract and thereby waived their right to cancel the transaction. Although the buyer had obtained a non-conforming mortgage commitment, which clearly could have been a default under other circumstances, the fact that the Co-op rejected the buyer for unrelated reasons, which reasons were not mentioned in its decision, allowed the buyer the right to terminate the contract and receive a refund of the downpayment.

2. Mehlman v. 592-600 Union Ave. Corp.

This decision was issued by the Appellate Division, First Department. The case was decided on December 18, 2007. In its decision the Appellate Division reversed the decision issued by the lower court and dismissed the action brought by the plaintiff, Mehlman.

A. The Facts of Mehlman

The buyer Mehlman and seller Corporation entered into a contract for the sale of commercial property owned by the seller for the price of $1,897,632.90. The contract provided for a Closing Date of "on or about May, 2002" and also included an outside closing date of October 7, 2002. Soon after the contract was signed the buyer's attorney, as is customary, ordered a title search on the property. The search revealed three (3) judgments against the seller. The judgments totaled approximately $650,000.00.

The Seller attempted to cure the outstanding judgments but was only able to remove one of them and could not clear the other two which totaled approximately $200,000.00. In July, 2002, the Seller notified the Buyer that it was ready to close and the title company was willing to close with money being deposited in escrow with the title company. This would have allowed the title company to issue a title insurance policy on the property to the buyer insuring that the buyer, Mehlman, would not be liable for the judgments.

In September, 2002 the seller corporation notified the buyer in writing that it had already expended the maximum amount required under the contract and that pursuant to Section 13.02 of the contract, the buyer was required to "either cancel the contract and receive a refund of its down payment and reimbursement of title costs or take the property subject to the title defects, with a modest credit." The buyer then rejected the seller's letter in its entirety and "unilaterally set a closing date of October 7, 2002,

with time being of the essence against the seller." The buyer argued that the attempt by the seller to set up the escrow modified the terms of the contract. The buyer, Mehlman, insisted that the seller close by the above date or else it would suffer the consequences.

The buyer and buyer's counsel appeared at the designated closing location and made a formal record establishing that the buyer was "ready, willing and able" to close that day. The buyer's attorney said he had the "bank or certified checks" and that they were ready to close. The Court pointed out that the checks were never shown to the seller. Again, the seller refused to close relying on the relevant section of the contract which gave the buyer the two remedies as detailed above (cancel or proceed subject to the title defects). The closing never occurred. Mehlman soon thereafter commenced an action against the seller "seeking specific performance and damages associated with seller's failure to close."

Once the lawsuit commenced Mehlman amended his complaint to include a cause of action against the seller for failing to cancel the contract pursuant to paragraph 7 of the rider to the contract which provided that the seller "shall be responsible to pay monetary liens, fines, interest and penalties in liquidated damages arising out of violations noted or issued against the premises on or before the closing date, provided however, that seller's liability with respect thereto shall not exceed $10,000.00 in the aggregate." The buyer argued that that the seller, based on buyer's interpretation of Paragraph 7 of the rider to the contract, had the option of either paying off all of the liens or cancelling the contract and the seller chose neither option.

B. The Supreme Court's Decision

Both parties moved for summary against the other. The lower court denied the seller's motion for summary judgment and "found that the buyer had standing to sue, and that because seller's principal did not observe the checks at closing, there was insufficient evidence to establish as a matter of law that buyer was not ready, willing and able to purchase the property." The court further ruled that "seller's reliance on section 13.02 as its excuse for nonperformance may have constituted an anticipatory breach, thereby obviating buyer's obligation to prove its readiness to purchase."

The buyer then made another motion for summary judgment on its action for specific performance. The buyer argued that because the seller failed to cancel the contract pursuant Paragraph 7 which required seller to "either pay all 'liens, fines, interest and penalties' or cancel the contract, and in this case the seller did neither," the buyer was entitled to specific performance. The trial court ultimately granted the buyer's motion for summary judgment and held that the seller failed to "properly cancel the contract pursuant to Paragraph 7 and therefore was in breach of the contract by refusing to close on October 7, 2002."

C. The Appellate Court's Reversal and Rationale

The seller then appealed the decision of the lower court to the Appellate Division. On appeal the seller argued that the lower court "misinterpreted the contract." Seller contended that its inability to satisfy the judgments prior to closing justified its invocation of section 13.02 and gave the buyer the choice to either cancel the contract or accept the property with title defects, and that by not choosing either course, buyer breached the contract." Seller also argued that even if "its invocation of section 13.02 or refusal to close could be seen as an anticipatory breach, buyer would still not be entitled to specific performance, due to its inability to demonstrate that it was ready, willing and able to close." The Appellate Division agreed with the seller on both points and reversed the decision of the Supreme Court.

The Appellate Division determined that the language of Paragraph 7 specifically deals with "monetary liens, fines, interest and penalties…arising out of *violations* [emphasis added] noted or issued against the premises on or before the closing…" and not with "judgments against the seller obtained by a private party." The buyer argued that Paragraph 7 applied to all liens, even judgments. The Court

explained that such an interpretation would have rendered the provisions of Paragraph 7 meaningless and of no force and effect.

Seller further relied on the clear and unequivocal language contained in Section 13.02 which was cited in the Court's decision:

> If the Seller shall be unable to convey title to the Premises at the Closing in accordance with the provisions of this contract…Purchaser, nevertheless, may elect to accept such title as Seller may be able to convey with a credit against the monies payable at the Closing equal to the reasonably estimated cost to cure the same (up to the Maximum Expense described below) but without any other credit or liability on the part of the Seller. If Purchaser shall not so elect, Purchaser may terminate this contract and the sole liability of the Seller shall be to refund the Downpayment to Purchaser and to reimburse Purchaser for the net cost of title examination…. Upon such refund and reimbursement, this contract shall be null and void and the parties hereto shall be relieved of all further obligations and liability…. Seller shall not be required to bring any action or proceeding or to incur any expense in excess of the Maximum Expense specified in Schedule D (or if none is so specified, the Maximum Expense shall be one-half of one percent of the Purchase Price) to cure any title defect or to enable Seller to otherwise comply with the provisions of this contract….

The Court, citing a prior case, provided that "[w]hen a contract for the sale of real property contains a clause specifically setting forth the remedies available to the buyer if the seller is unable to satisfy a stated condition, fundamental rules of contract construction and enforcement require that we limit the buyer to the remedies for which it provided in the sale contract." The Court, therefore, held that since the buyer Mehlman failed to elect one of the two remedies allowed under Section13.02, it was the buyer that was in breach of the contract, not the seller.

3. Valdina v. Martin

In **Valdina** the Appellate Division, Third Department, in its decision entered on January 24, 2008, affirmed the decision of the lower court which dismissed the complaint of an independent licensed broker who sued the seller of real property and the listing broker, Old Ghent Realty, for his commission. In this case the seller decided not to proceed with the transaction. The seller refused to execute the contract and returned it to the buyer along with the downpayment.

A. The Facts of Valdina

The sellers, Patricia Martin and Joan Mackey, entered into an exclusive listing agreement with the Old Ghent Realty. The plaintiff, Eric Valdina, an independent licensed broker procured buyers. A binder agreement was signed by the buyers and sellers which required that formal contracts were to be prepared and that certain inspections were to be conducted. The contracts were prepared and forwarded to the buyers, who signed them and returned them to the sellers with a downpayment check. The sellers decided not to proceed with the transaction and never executed the contracts. Rather, the sellers returned the contracts to the buyers unsigned along with the deposit.

The plaintiff, Valdina, commenced this action against the sellers and Old Ghent Realty seeking payment of half of the 6% commission that the sellers and the listing broker had agreed to pay arguing that he had produced a "ready, willing and able" buyer.

B. The Supreme Court's Decision

The sellers and Old Ghent Realty both made a motion to dismiss the case. The Sellers argued that they had no contract directly with the plaintiff and therefore, had no duty or obligation to pay the

buyer's real estate agent any commission at all. Old Ghent Realty basically argued that since there was no transaction and since it received no commission, it was not obligated to pay a commission to the cooperating broker. The Supreme Court granted the motions and dismissed the case. The plaintiff cooperating broker then appealed the decision to the Appellate Division.

C. The Appellate Division's Decision in Valdina

The Appellate Division agreed with the Supreme Court and held that since there was no agreement (i.e. contractual privity) between the sellers and the plaintiff, the action against the sellers was required to be dismissed. The Court explained that even if there was a closing the sellers are only required to pay a commission to the listing broker. It is then the listing broker that must agree to split the commission with a cooperating broker, either by entering into an actual agreement or in connection with the requirements of the multiple listing service in which the brokers may be members.

The Court then affirmed the decision of the Supreme Court granting Old Ghent Realty's motion to dismiss. The Court, citing another Appellate Division case, held that "[i]n order to entitle one broker to receive compensation from another broker on an agreement to divide commissions on the sale of real property, the commission must have been actually received by the broker whom it is sought to charge with liability [*Citations omitted*]." In this case Old Ghent Realty never received a commission and therefore, did not have any duty to pay half of the commission to the plaintiff. Old Ghent Realty did not dispute that it agreed to split its commission with the plaintiff.

The Court noted that Old Ghent Realty presented evidence that it "rarely" pursues a commission from a seller unless a transaction actually closes. One can only guess that there may have been some sort of language in the listing agreement limiting payment of a commission only "if, as and when" a closing occurs.

4. Contracts Govern Relationships Between Parties

The above cases illustrate that contracts are an important part of every transaction. No matter what level of the transaction, i.e., between a buyer and seller; or the listing agreement between a seller and listing broker; or the agreement between a listing broker and cooperating brokers, it is critical that every party to a transaction be fully aware of the contract provisions.