

COMMISSION ENTITLEMENTS

Debunking Some Common Myths

About Commission Entitlement



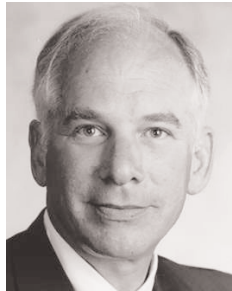
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Many commercial real estate practitioners (hopefully, not too many SIORs) seem to rely on information that should be categorized as folklore or myth when it comes to work habits intended to protect their commission interests.

The industry is full of misinformation that has led to a pattern of haphazard practices, most of which are apt to prove valueless in the context of mediation, arbitration, or even litigation. When coupled with an unfounded belief in the goodness of others, or in abstract concepts like "fairness"¹, these practices, for all intents and purposes, rely on the existence and beneficence of the 'Commission Fairy.'

If you rely on half-truths and legends distilled from the putative wisdom of other practitioners, or half-baked recommendations from attorneys who are unfamiliar with established industry policies, you may be sorely disappointed—particularly if you are compelled to resolve a disagreement over compensation through the dispute resolution mechanisms mandated by NAR or the Society.

Since most compensation disputes are subject to mandatory arbitration under NAR and SIOR protocols, here are some of the most common mistakes you must avoid:

1. Not Forming a Legally Enforceable Contract that Spells Out the Terms of Compensation.

In NAR and SIOR arbitration proceedings, findings of entitlement are based first on the elements of *contract formation*, and second on the

subsequent fulfillment of the agreed upon terms and conditions of this contract.

Said another way, Arbitration Hearing Panels are initially looking for two things:

- a. a contract that clearly delineates the terms and conditions of the compensation to which you are claiming entitlement; and
- b. performance of the covenants to which you agreed as your part of the bargain.

It's Up to You—You are responsible for arranging your own compensation. It isn't anybody else's job. Nobody is obligated to vouchsafe your entitlement to a commission. If you get into a dispute about compensation, it doesn't necessarily mean that somebody else did something wrong. It may very well mean that you failed to make the required arrangements—in essence, pricing your services on the basis of a *volunteer*.

Stipulate Specific Contact Terms—Arranging for compensation means negotiating a contract with one (or more) of the parties to the transaction (the property owner, the listing agent, the buyer, or the tenant). This contract should spell out the specific terms that define your compensation. If you can prove that you performed under the contract, its terms will be upheld and enforced in any arbitration proceeding.

If you can't prove;

- (a) that you formed a legally enforceable contract detailing the terms of your compensation and
- (b) that you then performed in accordance with the agreed upon terms, we can save you a lot of time and energy.

You're not going to be happy with the dispute resolution outcome. If there is no contractual chain that connects the dots between your claim and the compensation you are seeking, you are not going to fare well in an arbitration proceeding.

Establish Contractual Privity—For the purpose of clarity, it is also essential to understand that you must establish contractual privity with the party from whom you are seeking compensation. If you have a contract with a tenant or buyer that denominates you as their agent, and refers to compensation that is going to be due from and paid by *somebody else*—unless that somebody else acknowledges an obligation to pay you in accordance with clearly defined terms—you have not established contractual privity and do not have an enforceable claim.

Similarly, in most instances, it would be wrong for you to cite a listing contract as the basis for an entitlement if you are not a party to that contract. Arguing that you are an “intended beneficiary” of the listing contract will probably not score any points with an arbitration hearing panel unless you can demonstrate that an offer of compensation was made by the listing agent, that you accepted it, and that you then performed in reliance upon it and in accordance with its terms.

Create Enforceable Agreements—Finally, compensation agreements must be legally enforceable. If the agreement fails to conform to the tenets of contract formation (for example, if it violates the Rule Against Perpetuities), an arbitration hearing panel will set it aside after conferring with counsel.

2. Misunderstanding the Concept of “Procuring Cause”
Many practitioners believe that procuring cause works

according to the following syllogism:

*Procuring cause determines entitlement to compensation.
I am the procuring cause.
Therefore, I am entitled to compensation.*

It doesn't work that way. Without a contractual foundation, a demonstration of procuring cause will not prevail in an arbitration proceeding.

Perform As You Have Agreed—Procuring cause is a performance metric. It determines the degree to which you are involved in the series of events that leads to a successfully consummated transaction. It, alone, does not determine whether you are entitled to compensation. You may persuade the hearing panel to agree that you were, indeed, the procuring or contributing cause of a transaction and, nonetheless, be found to have no enforceable compensation claim for lack of a contractual foundation.

Linkage Is Required—Also, a requisite condition of procuring cause is an uninterrupted chain of events. You may submit an available property to a prospective buyer or tenant—or show an available property to a prospective buyer or tenant—or even commence negotiations for the purchase or lease of an available property with a buyer or tenant—and later find that your position has changed as the result of a break in the continuity of the chain of events.

If the chain of events is interrupted (your agency or representation agreement might be terminated by your client, for example—or you might drop the ball and find that you have been replaced²), you will probably not be found to be the procuring cause of the transaction.

3. Misunderstanding the Meaning of “Cooperation”

If a listing broker has agreed to “cooperate” with you (or vice versa), there is no explicit or implied agreement to share a commission. *None!* This is not a new concept. In November 1988, the National Association of REALTORS® adopted the following definition of “cooperation”:

“The obligation to cooperate, established in Article 3³ of the Code of Ethics, relates to a REALTORS®'s obligation to share information on listed property and to make property available to other brokers for showing to prospective purchasers when it is in the best interest of the sellers. An offer of cooperation does not necessarily include an offer to compensate a cooperating broker. Compensation in a cooperative transaction results from either a blanket offer of subagency made through MLS or otherwise, or offers to compensate buyer agents, or other arrangements as negotiated between listing and cooperating brokers prior to the time an offer to purchase is produced.”⁴

Cooperation and Compensation Are Two Separate Matters—The definition above is expressed in some of the covenants in both the NAR *Code of Ethics and Standards of Practice* and the SIOR *Code of Ethical Principles and Standards of Professional Practice*. Both Codes make it clear that cooperation and compensation are two separate and distinct matters.⁵ But the languaging habits that many of us have adopted do not make this distinction.

Don't “Assume” Compensation Terms—When we say

“cooperate” (or use related terms like “co-broker” or “cooperating broker”), there is often an assumed element of compensation. If you make that assumption—and then find yourself trying to persuade an arbitration hearing panel to your point of view—we can save you some time and energy. *It won't work.* You are going to lose the argument. An arbitration hearing panel is going to abide by established policies—and will not find in your favor unless you can clearly demonstrate (the standard of proof is “preponderance of the evidence”⁶) that you have a *contractually* derived claim for the compensation you are seeking.

4. Relying on “Local Customs and Practices”

Many commercial real estate brokers seem to believe there's something special about the way they do business in their local market—that there are unwritten rules recognized and subscribed to by other local practitioners—that there are principles above and beyond the principles outlined in any policy or code.

Sorry. If you find yourself involved in an arbitration proceeding, your claims must conform to official protocols that have been in place for decades. These policies are intended to apply universally and consistently over the entire geography occupied by NAR and/or SIOR members.

Policies and Protocols Rule—These policies do not allow for *any* predeterminants to entitlement. There is no rule that says that a cooperating broker is entitled to half of a listing broker's commission. There is no rule that says entitlement can be derived from past dealings between the parties. There is no rule that says you are entitled to anything—except the benefits that are confirmed by the dynamics of contract formation and performance.

In 1973, NAR adopted a policy that denies the establishment of any custom, rule, or practice that “establishes, limits, or restricts the REALTOR® in his relations with a potential purchaser, affecting recognition periods or purporting to predetermine entitlement to any award in arbitration. . . .”

In 1977, this protocol was enhanced to provide that a local Board or MLS “may not establish a rule or regulation that purports to predetermine entitlement to any awards in a real estate transaction. If controversy arises as to entitlements to any awards, it shall be determined by a hearing in arbitration on the merits of all ascertainable facts in the context of the specific case in controversy.”

These protocols are applied in SIOR arbitration hearings. In fact, this is one of the reasons that SIOR arbitration hearing panels are comprised of parties who are disinterested from the protagonists—not from the same market area, not in the same company or network, etc. It's also one of the reasons that Society arbitrations don't take place at the local level. The process is designed to avoid these kinds of prejudices.

Arbitration Panels and Case Precedents Don't

Matter—Along these same lines, arbitration hearing panels do not rely on (or even consider) case precedents. If you are required to arbitrate a matter, and you (or your attorney) come armed with an assortment of cases in which the findings favor the position you are espousing, the hearing panel will listen attentively and politely to your presentation—and then ignore everything that you said when making its decision. It's often not hard to find precedents that support both

sides in a dispute.

The applicable protocol, from NAR's *Code of Ethics and Arbitration Manual*, comes under the heading “No predetermined rule of entitlement” and states in pertinent part: “‘Rules of thumb,’ prior decisions by other panels in other matters, and other predeterminants are to be disregarded.”

5. Relying on “Market Rates and Terms”

Within the context of an arbitration proceeding, there are no such things as market rates and terms. A compensation claim that is not firmly anchored in very clear and specific terms is an invitation to relearn some basic arithmetic: If you multiply any number by zero, the result is zero.

If you put a hearing panel in the untenable position of determining the amount to which you are entitled as a derivative of nebulous information, you are probably not going to like the panel's conclusion. Since there are no permissible predeterminants, and since local customs and practices are disregarded, there may not be any benchmarks for gauging your compensation.

When you establish a compensation agreement, use real numbers.

6. Not Saying What You Mean or Meaning What You Say.

Lease or sale transactions are not geometric objects—they do not have “sides.” There are no policy definitions for things like the “listing side” or the “selling side” of a transaction. If you use confusing terms like this when you negotiate the fee split in a cooperating transaction or referral, and the matter then winds up in an arbitration hearing, you are probably going to lose your argument.

If, by way of example, you offer to share 50 percent of the “listing side” of the referral of a listing, an arbitration hearing panel is not going to understand (or care) that what you really meant was 25 percent of the gross commission. If it looks like 50 percent, the hearing panel is going to assume either that you meant 50 percent or that you were playing some kind of game and were not negotiating in good faith.

In either event, the award will likely be 50 percent of the gross commission. So, if you really mean 25 percent of the gross commission, make sure your contract clearly stipulates what you mean—and that the other party understands and acknowledges the specific terms.

7. A Handshake Will Not Do

In the absence of clear and incontrovertible documentation, an arbitration hearing becomes little more than an “I said/he said” contest. If you are seeking to enforce a commission claim, the absence of written contractual documentation will hurt your case considerably, perhaps (often) fatally.

Arbitrators do not like to be put in the position of distilling terms and intentions from a chain of events that has no documented contractual links. Contracts are supposed to be in writing. That's what both the NAR and SIOR codes say.⁷

If the only written evidence you have is your appointment book and the receipts from shipping out drafts of a lease or contract of purchase and sale, you are probably not going to clear the “preponderance of the evidence” hurdle.

Remember, if you are seeking compensation from an owner or another agent, it's your case to prove—not his or her case to disprove.

8. Attempting to Leverage Compensation Terms by

Manipulating an Offer to Purchase or Lease.

Using the terms of offers or counteroffers made on behalf of clients to establish or modify terms of compensation can lead to serious allegations of unethical conduct.⁸

Establish Compensation before Negotiating—If you are representing a buyer or tenant and you are expecting to be paid by the property owner (as seller or lessor) directly or through the owner’s agent, you would be well advised to establish the terms of compensation prior to entering into negotiations. If you use the purchase or lease negotiations as a fulcrum for establishing or modifying your compensation, do so only with great care. Setting forth terms of compensation in an RFP or RFQ is generally an acceptable approach—but the terms that you outline should harmonize with the terms outlined in your representation agreement with your client, the tenant, or buyer.

Similarly, if you are acting as an owner’s agent, you should establish the terms of compensation (consistent with your agency agreement and any other understanding you have with the property owner) with a buyer or tenant broker prior to the commencement of negotiations. Thereafter, you should not allow the sale or lease negotiations to become entwined with negotiations over compensation.

Note that in each instance, the compensation terms should be set prior to the commencement of the sale or lease negotiations. Circumstances may later warrant a modification of the compensation terms, but such modification must be negotiated in good faith: it must not be used as leverage in ways that may conflict with the interests of the principal parties.

Compensation Shouldn’t Be a Factor in Sale or Lease Negotiations

—If you bring a case in which you improperly used the sale or lease negotiations to set or modify the terms of your compensation, two things are likely to happen:

- (a) you will probably lose the arbitration, and
- (b) you may wind up in an ethics hearing after the arbitration hearing is concluded.

To the greatest degree possible, your compensation should never become a factor in sale or lease negotiations. If it becomes a factor, there is something askew—and your conduct (or the conduct of the other parties, if they are acting in bad faith) will be viewed critically in any professional standards proceeding.

Stick to Professional Standards to Ensure Appropriate Compensation

The eight above are the most frequent and glaring mistakes that we’ve encountered in various professional standards contexts. Some of these issues have come up in arbitration or ethics proceedings. Some have arisen in litigation. And some have been raised as questions in ethics seminars and other venues.

Are there exceptions? Sure. You might not be able to secure a compensation agreement because another party is not negotiating in good faith. Your rights and interests might be harmed by the improper conduct of others. But these things will likely work in your favor in a dispute resolution proceeding.

Bear in mind that both the *NAR Code* and the *SIOR Code*

are, themselves, contracts containing terms to which, as they apply, REALTORS® and SIORs are obligated. Arbitration hearing panels consider the conduct of the parties. If the conduct of another party has disparaged your compensation rights and interests, and this conduct is deemed to violate the tenets of the *Code*, an arbitration hearing panel will weigh the effect of this misconduct in its deliberations.

What is fundamentally important is for you to do the right thing—and take the high road. If you find yourself involved in circumstances in which another party is engaging in questionable conduct, don’t “fight fire with fire.” If you can’t reach a compensation agreement, have the money held in escrow—if possible—and then submit the dispute for resolution under the Society’s policies (which allow for resolution either through the Society, through a local NAR Board or Association, or through a recognized provider like the American Arbitration Association).

More importantly, adopt practices that avoid these common pitfalls and mistakes. More often than not, the kinds of cases that wind up in arbitration could have been easily avoided by paying more attention to some basic precepts. Once you understand these precepts, the solutions to most compensation issues should be more obvious—and you should have less difficulty developing work habits that maximize the probability that you will be paid for the services you render.

¹ Note that there is no Article in the *NAR Code* or Principle in the *SIOR Code* that establishes a duty of fairness as an ethical precept. Fairness is a subjective and relative concept—and in a business as competitive as commercial real estate, not easily distilled from the dynamics of disagreements over money. Competitive outcomes often seem unfair to one party or the other. The resolution of compensation disputes follows this pattern closely.

² For a more thorough understanding of breaks in continuity, see Principle 14 and its associated Standards of Practice in the *SIOR Code*.

³ Principle 13 in the *Society’s Code*

⁴ *Professional Standards Policy Statement #31 from the Code of Ethics and Arbitration Manual of the National Association of REALTORS®.*

⁵ See Article 3 in the *NAR Code* and Principle 13 in the *SIOR Code*.

⁶ This is further defined as: “evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the facts sought to be proved are more probable than not.”

⁷ The *NAR Code* contains a broad preference for written contracts in its Article 9, and the *SIOR Code* is quite specific about compensation agreements in Principle 6 and its related Standard of Practice 6.1.

⁸ See Standard of Practice 16-16 in the *NAR Code* and Standards of Practice 4.1, 4.2, 4.3, 12.1, 13.5 and 14.5 in the *SIOR Code*.

[For more information on the *SIOR Code*, visit www.sior.com—click on Membership.] ❖

