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Expert Analysis

Bankers Beware: The Reach of the Procuring Cause Standard

By Curtis Leitner and MarcAnthony Bonanno

In our last New York Law Journal article, "Bankers Beware: The Judicial Divide Over Customary Investment Banking Fees" (Nov. 14, 2022), we highlighted the conflicting New York case law on the application of the "agreement to agree" doctrine to investment banking fees. This article highlights another potential area of contract uncertainty for investment bankers, principals, and counsel—the procuring cause standard.

Under New York law, it is well-established that, absent an agreement otherwise, a real estate broker is not entitled to a commission unless she is the "procuring cause" of the sale or lease. The procuring cause requirement is not common in investment banking contracts. Nonetheless, a 2014 decision by the Court of Appeals, *Morpheus Capital Advisors v. UBS AG*, 23 N.Y.3d 528 (2014), held that, in a related context, investment banking contracts are governed by the same principles as real estate brokerage contracts. *Morpheus* could be used as an invitation to apply the procuring cause standard to investment banking contracts as well. Below, we assess the post-*Morpheus* case law applying the procuring cause standard to investment banking contracts and suggest that contracting parties tread carefully.

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Procuring Cause Standard

The procuring cause standard is a pervasive tool for resolving disputes over real estate brokerage commissions—typically, when the seller refuses to pay a commission on the grounds that the sale did not result from the broker's efforts. In a leading recent case, *SPRE Realty, Ltd. v. Dienst*, 986 N.Y.S.2d 92 (1st Dep't 2014), the First Department held that a procuring cause requires a "direct and proximate link, as distinguished from one that is indirect and remote, between the introduction by the broker and the consummation of the transaction." It is not enough to have "called the property to the attention of the buyer."

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On the other hand, the broker need not "have been the dominant force in the conduct of the ensuing negotiations or in the completion of the sale." Where between these two poles—flagging a potential buyer and acting as the dominant force behind a sale—a broker becomes the "procuring cause" is left to the trier of fact. The standard is vague, difficult to apply, and fertile soil for litigation in real estate transactions.

The procuring cause standard is grounded in a policy judgment. The Court of Appeals explained that, without the procuring cause standard, "given the enterprise which our competitive society prizes in its brokers and its salesmen, a veritable morass of claims to proprietary rights in their prospects would result." *Greene v. Hellman*, 51 N.Y. 2d 197 (1980). In other words, if the threshold for real estate brokers to claim a commission were too low, property owners would be saddled with brokerage claims and the right to dispose of one's property would be unduly encumbered.

'Morpheus'

In *Morpheus*, the New York Court of Appeals addressed another common issue in real estate brokerage disputes: the distinction between an exclusive right of sale and an exclusive agency. An exclusive right of sale requires the owner to pay the broker's commission in the event of *any sale*—even if the owner identified the buyer and effected the sale entirely on her own. An exclusive agency merely precludes the owner from engaging another broker; the owner remains free to sell her property on her own without incurring a commission.

Morpheus involved UBS's transfer of $39 billion of toxic student loan assets to the Swiss National Bank. UBS engaged Morpheus as its investment banker, but UBS effected the transfer without Morpheus's assistance. Morpheus argued that it was still entitled to a commission because the investment banking contract granted Morpheus an exclusive right of sale. Specifically, the contract granted Morpheus "the exclusive right to solicit counterparties for any potential Transaction involving the Student Loan Assets during the term of this Agreement."

The contract had other provisions supporting Morpheus's argument. For example, it stated that Morpheus "shall receive a Success Fee payable upon the closing of any" transaction involving the student loans. It also stated that Morpheus was not entitled to a fee if UBS initiated a deal with two entities that had already been identified by UBS—an exception that would arguably be unnecessary if UBS had no obligation to pay a commission for a self-directed transaction.

Supportive contract language, however, is not the same thing as a clear statement. The court held that a contract giving rise to an exclusive right of sale is subject to a clear statement rule, and Morpheus's contract was not clear enough. To satisfy the rule, the contract must provide "an unequivocal expression" of intent to confer an exclusive right of sale "by its own terms or by necessary implication from its terms." The clear statement rule is "consistent with the general principle that an owner's freedom to dispose of her own property should not be infringed upon by mere implication."

The court listed several examples of language that would be sufficiently clear, including where an owner agrees to "proceed only through the broker and will not directly or through others negotiate the sale"; to "refer all inquiries or offers" to the broker for negotiation; or to pay a commission "regardless of whether the broker has actually procured the Purchase Agreement."

Morpheus argued that any clear statement rule should be limited to real estate transactions. The court disagreed. It held that the clear statement rule is applicable to both real estate brokerage and investment banking contracts, which, at least in some cases, share the same governing principles:

While it is true that much of the relevant Appellate Division case law arises in the context of the lease or sale of real property, we see no reason to apply a different rule to brokerage contracts concerning the sale of financial instruments in the investment banking context. In both cases, the governing principles arise from the law of agency and contract, not from the law of real property. Accordingly, in both cases the owner must expressly agree to forfeit the right to directly convey its own property to a third party without incurring a broker's fee.

Morpheus left open the extent to which *other* aspects of the case law on real estate brokerage contracts are applicable to investment banking contracts—including the procuring cause standard.

Procuring Cause in Investment Banking Contracts

The application of the procuring cause standard to investment banking contracts would sound bizarre to many, if not most, investment bankers. It is not uncommon for investment bankers to be entitled to a success fee for a completed transaction when they did not facilitate the transaction. Certain counterparties, typically parties who are already negotiating with the principal, may be "carved out" from the deal. A "carve out"—rather than the procuring cause standard—is the common mechanism to exclude counterparties from the reach of an investment banking contract. Indeed, it is much easier to identify a counterparty on a schedule than to determine whether an investment bank was the "procuring cause" of a deal with that counterparty.

Additionally, many investment banking contracts have a "tail" provision, which entitles the investment bank to a success fee if a deal closes with a counterparty introduced by the investment bank within a certain period after the contract expires. The existence of a tail anticipates that there may be a temporal gap, or lack of proximity, between the investment banker's role and the successful completion of the deal. Thus, a tail may be inconsistent with the "direct and proximate link" required by the procuring cause standard.

Notwithstanding the differences between real estate brokerage and investment banking contracts, a few New York cases have applied the procuring cause case law, drawn from real estate brokerage disputes, to investment banking contracts. And at least one Southern District case has done so in reliance on *Morpheus.* In *Dominick & Dominick v. Deutsche Oel & Gas*, No. 14-CV-06445, 2016 WL 11259075, at *4 (S.D.N.Y. Aug. 15, 2016), an investment bank claimed it was entitled to a success fee for a financing that its principal negotiated without the investment bank. Although the investment bank admitted that it did not "bring in" the investor, the investment bank identified the investor on a target list provided to the principal.

As in *Morpheus*, the court held that the contract did not clearly establish that the investment bank had an exclusive right of sale, and thus the investment bank merely had an exclusive agency. *Dominik*, however, went farther than *Morpheus*. *Dominik* held that, "[b]ecause the Agreement is an exclusive agency … the intermediary must be a 'procuring cause' of a transaction." The court found that identifying a counterparty on a target list does not satisfy the procuring cause standard, and thus the investment bank was not entitled to a success fee.

Dominik notwithstanding, the rejection of an exclusive of right of sale in favor of an exclusive agency does not *necessarily* mean that the procuring cause standard applies. The exclusive investment banker for a capital raise or merger could be entitled to a success fee for making an introduction to a potential counterparty, or even identifying the counterparty for the principal. It depends on what the contract says. Moreover, it is not clear that the policy underlying the procuring cause standard in the real estate context (i.e., preventing a "veritable morass of claims" by real estate brokers) carries over to the investment banking context. There remains little post-*Morpheus* case law on the reach of the procuring cause standard in the investment banking context.

Conclusion

Contract disputes are usually decided by reading the contract as a whole to ascertain the parties' intent and considering extrinsic evidence to clarify ambiguities. A clear statement rule is a substantial departure from the ordinary principles of contract interpretation. It cuts off the analysis of the parties' intent and stacks the deck against a disfavored outcome—in *Morpheus*, an exclusive right of sale.

Morpheus and *Dominik* raise the prospect that courts—and certainly parties litigating an investment banking fee—will be tempted to stack the deck in favor of a vague and fact-specific procuring cause standard. Once again, bankers beware. Parties to investment banking contracts should take care to ensure that the trigger for the investment banker's success fee—whether identifying the counterparty, making an introduction, negotiating the deal, or otherwise—is stated in clear terms.