

REAL ESTATE LITIGATION

Enforceability of Indefinite Terms In Real Estate Contracts

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In today's fast moving transactional environment, investors and other players in the real estate market are working to ink deals as quickly as possible. Often, the transactional documents leave terms open and undefined and subject to the whims of third parties not involved in the transaction. When those obligations are performed, there is no controversy. But what happens if it becomes impossible to meet an obligation or a party simply fails in its performance? Think you had a deal? Not so fast.

In order to enforce contractual provisions, it is not enough that the parties understood the terms or believed themselves to be bound. Rather, a contract must be sufficiently definite for a court to ascertain the parties' intent with relative certainty. A subjective clause in a contract may not be enforceable where terms are left open to future negotiation or not sufficiently defined.

This "definiteness" requirement is among the oldest in contract law but often is forgotten in a time where the pace of transactions and client pressure to "get the deal done" necessitates that certain terms be left open. So drafters beware. If a contract lacks objective criteria by which to measure a party's performance, courts will refuse to enforce a term that on its face is indefinite—without regard to fairness or consequences.

The Rule of "Definiteness"

It has long been held that definiteness as to material terms of a contract "is of the very essence in contract law."¹ "Impenetrable vagueness and uncertainty will not do."² And if an agreement is not reasonably certain in its material terms, "there can be no legally enforceable contract."³ Thus, for a contractual clause to be enforceable, there must exist objective criteria against which to measure the party's efforts.⁴ In fact, even when the parties "believe they are bound, if the terms of the agreement are so vague and indefinite that there is...no means by which such terms may be made certain, there is no enforceable contract."⁵

Pitfalls

Courts endeavor to hold the parties to their bargain "where it is clear from the language of an agreement that the parties intended to be bound and there exists an objective method" for supplying a missing term or measuring performance.⁶ Thus, in the absence of facial definiteness, the Court of Appeals has identified two ways in which the requirement of definiteness still can be satisfied: Where an agreement (1) contains a methodology for determining the meaning of the term; or (2) invites recourse to "an objective extrinsic event, condition or standard" on which to rely.⁷ Absent such a methodology or another objective measure, courts by necessity will deny enforcement of the contract.

A recent decision from New York County Supreme Court demonstrates the pitfalls of entering into a contract without regard to the definiteness requirement. In *Gallotti v. Advance Watch Co.*, the dispute involved a

bonus owed to plaintiff under his employment agreement with Advance Watch Co., d/b/a Geneva Watch Group (Geneva), pursuant to a clause providing that he was "eligible for a medium term incentive based on the increase in the shareholder value of [Geneva]," and that the "objectives and metrics used to define and measure the achievement under this plan will be defined within one month from the approval of the strategic business plan of [Geneva]."⁸ But the "objectives and metrics used to define and measure" the bonus never were defined and Nicola Gallotti never received the bonus prior to being terminated. Gallotti subsequently brought suit to recover the bonus.

In granting Geneva's motion to dismiss, the court repeatedly emphasized that it only could consider an objective standard for determining the bonus, "independent of either party's mere wish or desire." The court explained further that objective criteria "may be found in the agreement itself, commercial practice or other usage and custom." But there was no "objective criteria" that it could use to compute the bonus (even though it was tied to an increase in shareholder value, which allegedly increased by \$60 million during Gallotti's employment), and the court explained that "any percentage proffered by Gallotti, Geneva, or even [the court] will merely be a made-up number with no objective nexus to the parties' intentions." Furthermore, there were "no applicable industry standards" that the court could look to when determining the bonus, as the agreement had been "uniquely negotiated between the parties."

The plaintiff in *Gallotti* would not have been surprised by the result based upon prior case law. For instance, the definiteness require-

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ment also came into play in *Strauss Paper v. RSA Executive Search*.⁹ There, the plaintiff corporation (Strauss) and the defendant, an executive search firm (RSA), entered into an agreement where RSA agreed to “find an ideal candidate for the senior sales management position advertised by Strauss.” The agreement further provided that the candidate would be “guaranteed” and that RSA’s “entire fee will be earned upon placement completion.” The agreement further provided that in the event the referred candidate resigned or was terminated within 180 days of hiring, the defendant would use its “best efforts to replace the candidate” at no additional charge, but did not define the words “best efforts.” Strauss subsequently hired one of the candidates referred by RSA and remitted one-half of the placement fee. But the employee was fired approximately four months after being hired, at which point Strauss demanded the return of its money. The lawsuit followed.

Strauss argued (and the court held) that the agreement, read as a whole, indicated that the placement fee was not earned unless and until the candidate remained in Strauss’s employ beyond the 180-day period. RSA’s response was that it was entitled to use its “best efforts” to obtain a replacement candidate. But the court rejected this argument in granting summary judgment to Strauss, holding that where an agreement expressly provides that a party must use its “best efforts,” it is “essential that the agreement also contain clear guidelines against which to measure such efforts in order for such clause to be enforced.” And the agreement contained no such guidelines, leading the court to hold that RSA could not seek to enforce its right to payment under that portion of the agreement.

Extrinsic References

So when will courts resort to extrinsic objective standards to render an agreement sufficiently definite? The Court of Appeals’ oft-cited decision in *Cobble Hill Nursing Home v. Henry & Warren Corp.* remains an excellent example.¹⁰ The contract there gave plaintiff an option to purchase a nursing home at a price determined by the Department of Health “in accordance with the Public Health Law and all applicable rules and regulations of the department.”¹¹ The trial court ultimately held that the option agreement was unenforceable for failure to specify a method by which price could be determined, and a divided Appellate Division affirmed.

In reversing, the Court of Appeals began its analysis by recognizing that a price term “is not necessarily indefinite because the agreement fails to specify a dollar figure, or leaves fixing the amount for the future, or contains no computational formula.” And there, in the court’s view, the price could be determined by reference to extrinsic standards. The court looked first to the contract’s language, which manifested the parties’ intent that price be fixed by a third person.

Moreover, the Health Department had an established objective means of fixing a price, by referencing Medicaid reimbursement to nursing home operators for real property costs, including reasonable rent, and where the operator was the owner, the reasonable costs of acquisition. Further, the court also considered the circumstances in which the agreement was made, which confirmed that the department was to have the authority to fix the price.

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A more common example is found in the mortgage context. For instance, in *Shreiber v. Delia*, plaintiffs sought specific performance of a contract for the sale of commercial real property.¹² In relevant part, the contract required defendants to apply for a 25-year conventional fixed-rate mortgage loan in an amount not to exceed the purchase price of \$325,000, and further provided that if defendants were unsuccessful, plaintiffs had the option “to obtain such financing on behalf of [defendants] or to provide same at current commercial loan rates.” Plaintiffs argued that they were ready, willing and able to perform, but the trial court dismissed the complaint on the ground that the essential terms of the mortgage to be provided by plaintiffs were lacking and that the contract was indefinite and therefore unenforceable.

The Appellate Division reversed, holding that the term and amount of the mortgage could be determined by reference to the language of the contract giving plaintiffs the right to provide the same type of financing

for which defendants were required to apply. Furthermore, the court held that the interest rate provided in the financing option—“current commercial loan rates”—could be determined by reference to an objective extrinsic standard that would make its meaning clear. Thus, reference to commercially available rates—most notably “prime”—does not render a contract indefinite.

Conclusion

As the cases discussed above make clear, parties should not assume that contractual clauses that are indefinite or create standards not tied to objective criteria will be enforceable just because an executed contract is in place. Rather, practitioners drafting such clauses should ask first whether all of the material terms are included and sufficiently defined. If not, they must provide further direction in the contract itself. In doing so, practitioners must ensure in the contract itself that a neutral judge interpreting the agreement will be able to determine with sufficient certainty what the parties intended. And to the extent that the contract necessitates inclusion of a facially indefinite term—for instance requiring a party to use “best efforts” or act “in good faith”—explain in the contract what does (or does not) satisfy this obligation, or, if possible, refer to an extrinsic objective source such as an accepted industry standard. As cases continue to show, failure to heed this advice can be costly.

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1. *Joseph Martin, Jr., Delicatessen v. Schumacher*, 52 N.Y.2d 105, 109 (1981).

2. *Id.*

3. *Cobble Hill Nursing Home v. Henry & Warren Corp.*, 74 N.Y.2d 475, 482 (1989); see also *Matter of 166 Mamaroneck Ave. v. 151 E. Post Rd. Corp.*, 78 N.Y.2d 88, 91 (1991) (“The doctrine of definiteness or certainty is well established in contract law. In short, it means that a court cannot enforce a contract unless it is able to determine what in fact the parties have agreed to.”).

4. See, e.g., *Digital Broad. Corp. v. Ladenburg, Thalmann & Co.*, 63 A.D.3d 647, 647 (1st Dept. 2009); *2004 McDonald Ave. Realty, LLC v. 2004 McDonald Ave. Corp.*, 50 A.D.3d 1021, 1023 (2d Dept. 2008); *Brown v. Bus. Leadership Grp.*, 57 A.D.3d 212, 213 (1st Dept. 2008); *Timberline Dev. v. Kronman*, 263 A.D.2d 175, 178 (1st Dept. 2000); *Strauss Paper v. RSA Exec. Search*, 260 A.D.2d 570, 571 (2d Dept. 1999); *Bernstein v. Felske*, 143 A.D.2d 863, 865 (2d Dept. 1988).

5. *Deligiannis v. PepsiCo*, 757 F. Supp. 241, 256 (S.D.N.Y. 1991).

6. *166 Mamaroneck Ave. Corp. v. 151 E. Post Rd. Corp.*, 78 N.Y.2d 88, 104 (1991).

7. *Id.* at 92.

8. Index No. 650474/2013 (SWK), 2013 N.Y. Misc. Lexis, at *2 (Sup Ct. Nov. 27, 2013).

9. 260 A.D.2d 570 (2d Dept. 1999).

10. 74 N.Y.2d 475 (1989).

11. *Id.* at 480 (1989).

12. 222 A.D.2d 1063 (4th Dept. 1995).