When You *DON'T* Have A Written Agreement

A New York Breach of Contract lawyer Reveals How You Can ***Still*** Recover Your Losses

x Jonathan M. Cooper, Esq.

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SEPARATING FACT FROM MYTH

Fortunately, over the last few years, I've been privileged to help a number of good, well-intentioned people who were wronged by a breach of contract. In that vein, however, I couldn't help but notice that an uncomfortable number of these people were terribly disillusioned, and surprised to learn that their cases had glaring weaknesses (and in some instances, they did not have a viable case at all).

Consequently, I decided to write this booklet about one issue that recurred with great frequency: when people fail to reduce their contracts to writing, and how this issue is handled under New York law.

I hope you will find it educational and helpful. And here's the best part: you can hopefully find answers to your question(s) from the privacy of your office or home – *even before you consult an attorney.*

This Book Is Not Legal Advice

It is also important that you understand the limitations of this book. Although I believe this book is extremely valuable as a resource, every case is unique,

and presents its own particular facts and legal issues. Consequently, please do not construe anything in this book to be legal advice about your case until we have mutually agreed in writing that I have accepted your case.

So, where to begin?

I think the best place to start is by debunking some myths about breach of contract cases in New York.

Fact #1: *Prosecuting or defending a breach of contract action in New York is not simply a question of wrong or right.* Unfortunately, given the intricacies and technicalities of New York contract law, this issue tends to be far more complicated.

Fact #2: *Since the world of business litigation in general, and breach of contract cases in particular, is intricate (see Fact #1), there are relatively few "nuisance value" breach of contract cases that are worth pursuing in New York.*

Myth #1: *If Someone Breaks Their Promise to You, You Are Automatically Entitled to Recover in Breach of Contract*

In most cases, this is simply untrue. And that is because under New York law, many of the most common types of

agreements must be reduced to writing in order to be enforceable.

On the other hand …

<u>Myth #2:</u> *If You Don't Have a Written Agreement, You Can't Have a Valid Case*

While it is true that in many, if not most, cases you will not prevail on a breach of contract claim absent a written agreement, there are some instances (which are discussed below) where you can still recover damages for a breached agreement that was never reduced to writing. One example would be in the employment context, where wages or commissions were already earned but never paid. A second, and more common, example is where a contract can be implied based upon the parties' conduct.

But before we get there, we first need to establish how the law evaluates whether there was an agreement to begin with – whether written or oral.

WHAT DO I NEED TO PROVE IN ORDER TO WIN MY BREACH OF CONTRACT CASE IN NEW YORK?

At the end of a jury trial, but before the jury "retires to deliberate," the Court gives the jury instructions in order to provide a framework within which they must consider the evidence they heard over the course of the trial, and determine whether the plaintiff proved her case.

These instructions have been largely formalized, and in New York, are known as the Pattern Jury Instructions. Although these instructions provide the most authoritative benchmark for what the plaintiff needs to prove at trial (as a result of which I have quoted extensively from their practice commentaries in compiling the following list), they are fairly difficult to understand and apply, because they are filled with a lot of "legalese," or "lawyer talk."

Naturally, since the types of breach of contract cases discussed above vary rather widely, the nature of the proof required correspondingly varies as well. Nevertheless, a common thread unites these different strands: the basic elements of a contract, and what you

need to prove in the event that the contract is breached.

In general terms, in order to establish a breach of contract claim under New York law, a plaintiff must prove the following 4 things:

(1) the existence of an (enforceable) agreement;
(2) that the plaintiff performed his end of the agreement;
(3) that the defendant breached the agreement; and,
(4) that the plaintiff sustained damages as a direct result of the defendant's breach.

A plaintiff's failure to prove any one of these elements should prove fatal to a breach of contract claim. Leaving aside, for the moment, the issue of enforceability (some types of agreements must be reduced to writing as required by New York's Statute of Frauds, and other agreements, such as illegal contracts, are unenforceable on public policy

grounds), the prong that most often dooms breach of contract cases is the first: proving the existence of an agreement. Here, the plaintiff is obligated to set forth the essential and specific terms of the agreement that the claim is based upon.

As a corollary to this rule, the following must be borne in mind: generalized breach of contract claims that are cast against a battery of defendants will fail unless the plaintiff can show a specific agreement with each defendant. In legalese, this is called "privity." In other words, if I enter into an agreement with A. Corp. to buy some widgets, and they breach the agreement, I have no inherent right to sue A. Corp.'s 5 other affiliates that weren't parties to the original contract, and did not tortiously interfere with or otherwise induce the breach of contract.[1]

[1] See, e.g., *Chen v. Street Beat Sportswear, Inc.*, 364 F. Supp. 2d 269, 294-95 (E.D.N.Y. 2005).

WHAT TYPES OF CONTRACTS MUST BE REDUCED TO WRITING?

Generally speaking, the Statute of Frauds (N.Y. Gen. Obl. Law §5-701, et seq.) , bars a claimant from recovering damages on a breach of contract claim if the agreement was not reduced to writing, and the agreement could not have been performed within one year. Applying that rule, New York's courts have held that the "negotiation of business opportunities," or "fee-finders" arrangements fall squarely within the ambit of the Statute of Frauds, and therefore, the essential terms of agreement must be reduced to writing in order to be enforceable.

Brooklyn Court Holds Oral Agreement Regarding Real Estate Unenforceable

Reading the Court's recent decision in *Malaty v. Malaty,* I couldn't help but wonder what the plaintiff or his attorney were thinking when they brought this breach of oral agreement and breach of fiduciary duty lawsuit.

In that case, the plaintiff Naguib Malaty sued his brother to compel the turnover of the defendant's interest in a Brooklyn property that was supposedly purchased with plaintiff's money, and for money damages in breach of contract and breach of fiduciary duty that the defendant purportedly owed to plaintiff's two corporations.

Plaintiff had a few "minor" problems with his claim, however. First, he had no proof that his corporations were actually legitimate (based upon the evidence adduced at trial, the Court opined that these corporations were set up solely for tax evasion purposes); Second, he had no written agreement memorializing the defendant's agreement to transfer ownership of the subject property to plaintiff, as a result of which his claim was barred by New York's Statute of Frauds.

In dismissing this branch of the plaintiff's claim, the Court cited the underlying theory behind New York's Statute of Frauds, which is over 100 years old:

> "The purpose of the Statute of Frauds is sufficiently indicated by its title. It is a statute against frauds. It was designed to prevent litigation over oral agreements, where the terms are always dependent upon the uncertain and varying memory of witnesses. This evil was to be remedied by the reduction of the terms of the contract to writing, so that the parties might not misunderstand the particulars of the contract which they were making; that no one might be induced to enter a court of justice to vex the peace of his opponent without clear and definite evidence of the terms of the contract which formed the ground of action, equally accessible to both parties and to the court; and that perjury might not be invited to sustain a claim which never had any real existence."

I find the irony in this decision amusing. The plaintiff figured that in attacking

his brother's integrity, no one would bother to question his own, and in so doing, lost sight of the fact that he could be setting himself up for an IRS audit and investigation.

When Negotiated Terms Don't Make It Into Your New York Contract

So you've spent weeks, maybe even months, of back and forth negotiations on this deal … and you've finally reached an agreement. And after the euphoria of finally closing the deal and closing on the contract wears off, a problem arises.

And when you go back to look at the contract you realize that some of the most important things that you had negotiated somehow never made it into the written contract.

Under New York law, this is called the "parol evidence rule," and here's the general rule:

> "Absent fraud or mutual mistake, where the parties have reduced their agreement to an integrated writing, the

> parol evidence rule operates to exclude evidence of all prior or contemporaneous negotiations between the parties offered to contradict or modify the terms of their writing. Although at times this rule may seem to be unjust, "on the whole it works for good by allowing a party to a written contract to protect *** himself from 'perjury, infirmity of memory or the death of witnesses.'"[2]

In other words, unless there is fraud involved, or both parties made the same mistake, you cannot enforce these additional terms that had been negotiated unless they were reduced to writing and made part of the contract. And while I hate to agree with the Court on this one, it is, in my view, the right result; otherwise, there would be almost nothing to prevent a party to a contract from

[2] *Fogelson v. Rackfay Constr. Co.*, 300 N.Y. 334, 90 N.E.2d 881; *Thomas v. Scutt*, 127 N.Y. 133, 27 N.E. 961; see, generally, Richardson, Evidence [10th ed.], §§ 601-634).

being able to avoid his obligations by simply saying that the agreement was changed by some other conversation they had.

WHAT YOU CAN DO UNDER NEW YORK LAW IF YOU DON'T HAVE A FORMAL WRITTEN (OR VALID) CONTRACT

After months of back-and-forth discussions and e-mails, you're promised a great new job, but it's out of town. You leave your current dead-end job, sell your house and move, hopeful that you can make a fresh start. But when you finally arrive at your new job, you learn that there's one "small" problem: they've eliminated your position. And then the reality sets in, which causes you to smack your forehead: you never got a written contract.

Consider another scenario: a long-time customer places a large order over the phone for your product; an order large enough that you hire additional staff and purchase additional machines just to accommodate the order. And then you learn that the customer has decided to back out. And, like in scenario #1, you go back and

realize that you forgot to reduce your agreement with the customer to writing, and worse, you're out hundreds of thousands of dollars.

While you might be inclined to just throw up your hands in frustration and walk away, that would probably be a mistake – at least under New York law. And the reason is a doctrine called "quasi-contract," which means that the Courts are obliged, out of a sense of fairness ("equity"), to restore the status quo ante, i.e., putting the parties back into their original positions, even where there is no written, valid and enforceable contract.

Two examples of this are as follows:

- *Promissory Estoppel* – As the Appellate Division, Second Department recently held, "[T]he elements of a cause of action based upon promissory estoppel are a clear and unambiguous promise, reasonable and foreseeable reliance by the party to whom the promise is made, and an injury sustained in reliance on that promise."[3] This type of claim would

[3] *Williams v. Eason*, 49 A.D.3d 866, 868 (2d Dept. 2008).

be equally applicable to the two scenarios listed above.

- *Unjust Enrichment* – In a different vein, an unjust enrichment claim is based on the unfairness inherent in the defendant benefiting from the plaintiff's services without paying for them. To that end, the Appellate Division, First Department summarized the elements of an unjust enrichment claim as follows: "To state a cause of action for unjust enrichment, a plaintiff must allege that it conferred a benefit upon the defendant, and that the defendant will obtain such benefit without adequately compensating plaintiff therefor."[4]

In order to prove a *quantum meruit* claim, the plaintiff must establish the following:

(1) the performance of the services in good faith;

[4] *Nakamura v. Fuji*, 253 A.D.2d 387, 390 (1st Dept. 1998).

(2) the acceptance of the services by the person to whom they are rendered;

(3) an expectation of compensation; and,

(4) the reasonable value of the services.

At this point, it bears emphasis that these claims are *only applicable in the absence of a valid, written contract.* Stated differently, a quasi-contract claim that is based upon the same facts and transactions as a breach of contract claim will be dismissed as duplicative.

SOME OTHER, NON-CONTRACTUAL WAYS TO RECOUP YOUR LOSSES

Although there are other non-contractual means of trying to recoup your losses, it should come as no surprise that these methods are not easy to prove, and are fraught with challenges. Following are some of the more frequently litigated types of claims.

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Breach of Fiduciary Duty

In my experience, there are few legal phrases that are more misunderstood or misapplied than "fiduciary duty." Within the confines of this limited piece, I hope to clarify this concept.

Before we can approach a fiduciary's obligations, we must define what a fiduciary is – and what it is not. A fiduciary relationship is characterized as one where there is inherently and significantly greater trust and confidence than that which exists between two companies that are dealing at arms' length. The more common examples of this relationship include the following: employee/employer, agent/principal, partners/co-venturers, and officers and directors/corporation. The existence (or lack) of a fiduciary relationship is, generally speaking, a fact-specific inquiry; in other words, there is no bright-line test. However, some relationships have been held too attenuated to be considered "fiduciary," such as arms' length transactions between an owner and contractor, or a condominium seller and purchaser.

Since the relationship between fiduciaries is based on heightened trust, there are correspondingly greater responsibilities to act in the best interests of that fiduciary. These responsibilities are strictly limited, however.

One important example is that of the employee who seeks to start a competing business. Although the employee may not actively solicit or divert his employer's clients (or proprietary information) while still employed, he may form a competing business ***even before*** leaving his job so long as he does so on his own time, in his own place and on his own nickel. And, strange as it sounds, that will not constitute a breach of fiduciary duty.

What Is Business Fraud (and How Do You Prove It Successfully In New York)?

In a parallel vein to the fiduciary relationship, business fraud claims typically arise in conjunction with breach of fiduciary duty and breach of contract claims.

As noted in my business litigation blog post, "*Why Many (If Not Most) Business Fraud Claims Are Dismissed*," a Manhattan judge recently decided that Dan Rather may

amend his complaint to re-assert his claim that his former employer, CBS, engaged in fraud in wrongfully terminating his employment contract.[5] Although I was admittedly not privy to many of the details of this case, this story is useful because it provides the impetus for us to review the standards of what a plaintiff must prove in order to prevail on a business fraud claim.

At the outset, it bears emphasis that given the highly inflammatory nature of a fraud claim, unlike, for example, a garden-variety negligence case, the New York State legislature saw fit to require a claimant to allege with great particularity the specific acts that constitute the fraud. See, CPLR §3016. Otherwise, the claim will be subject to dismissal at the pleadings stage, i.e., at the very beginning of the lawsuit, and before document discovery or depositions take place.

In addition, and in contrast to standard tort actions, which are determined based upon a "preponderance of the evidence," i.e., whether plaintiff's or defendant's version of the events is more

[5] This case was later dismissed due to the transparent weakness of the claim.

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Many small businesses' recurring nightmare, particularly in this economy, looks something like this:

Debtor D (we'll call him "D," for short) owes you tens of thousands of dollars for product that you delivered months ago. When you inquire as to what the delay is in receiving payment, you get a run-around, and ultimately find out that D's company was taken over by a small, closely held company whose priorities clearly do not include paying your bills. By now, you've put them on formal notice that unless D pays the bills in full, a breach of contract suit will be brought.

Recognizing that he will have no viable defense to your claim, the principal of D does what many short-sighted executives do: he divests the company of as many assets as possible and as quickly as possible, transferring properties into the name of his wife and other family members for little or no consideration. While many people in your situation would throw up their hands at this point, that may prove to be a terrible mistake. And that is because they are likely unaware of the doctrine of constructive fraud – the cousin of the alter ego/piercing the corporate veil doctrine.

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Unlike common law fraud principles, which require a showing of intent to defraud (which is difficult to prove), New York's Uniform Fraudulent Conveyance Act ('UFCA'), as codified in Article 10 of the Debtor and Creditor Law at §§ 270-281, *has several provisions that do not require a claimant to prove that the defendant had actual intent to commit a fraud*, and some of these provisions, such as section 273-a (entitled "Conveyances by defendants"), was specifically drafted to prevent debtors from escaping their obligations in a lawsuit. This doctrine is commonly referred to as "constructive fraud."

There is one important catch, however: in New York, as in other jurisdictions, "[A] transfer may not be challenged as fraudulent unless it prejudices the complaining creditor." In other words, in determining whether a creditor has been prejudiced, courts consider what rights, if any, the creditor would have had to levy on the property had the challenged conveyance not occurred. And if the creditor (i.e., you) would never have been able to recover any of that money because your claim was so far back in line of the other creditors, you will still be out of luck.

If Your Contract Was Tainted by Fraud or Mutual Mistake

Another option that may be available to recoup your losses, particularly in the event that a damages award will not make you whole, is the equitable doctrine of rescission, which aims to restore the "status quo ante," or in other words, put the parties to the contract back into the same position before the contract was entered into.

A word of caution is in order here: this doctrine is only available in limited circumstances, such as where the parties never achieved a "meeting of the minds," i.e., where both sides understood their respective obligations under the contract, or where one party was fraudulently induced into entering into the contract.

That said, here are some more grounds rules:

(1) Rescission "is to be invoked only when there is lacking complete and adequate remedy at law and where the *status quo*

may be substantially restored";[6]

(2) if the other party to the agreement substantially changed their position in reliance on the agreement, and it would prove impractical – if not impossible to restore the other party to the position they were in pre-contract (such as where two companies were merged).[7]

[6] *Rudman v. Cowles Communications, Inc.,* 30 N.Y.2d 1, 13, 330 N.Y.S.2d 33, 280 N.E.2d 867)

[7] See*, e.g., Gravenhorst v. Zimmerman,* 236 N.Y. 22, 34-35, 139 N.E. 766; *Kamerman v. Curtis,* 285 N.Y. 221, 226, 33 N.E.2d 530).

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Jonathan Cooper is, first and foremost, a husband and father to six (yes, that's right - 6) adorable children with whom he lives in Queens, New York. Less importantly, he has litigated numerous business litigation cases, ranging in complexity and scope from a simple breach of a sublease agreement to breach of employment agreements and State and Federal Class Actions against foreign and domestic manufacturers and distributors arising out of their breach of warranties regarding their products.

His firm's websites and blogs (www.JonathanCooperLaw.com and www.nysmallbusinessattorney.com) have been set up as a public service, providing a lot of free, useful information and links on a variety of topics, such as breach of contract, business fraud, defamation, and the different types of tortious interference claims under New York law, and are regularly updated.

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