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Why You Should Stay Away From Oral Agreements

Law360, New York (January 03, 2014, 1:16 PM ET) -- Litigation between two business school graduates over the termination of their oral partnership agreement lasted four years longer than their five-month partnership. Unless the goal is litigation, Gelman v. Buehler, 20 N.Y.3d 534. 964 N.Y.2d 80 (2013) reversing 91 A.D.3d 425 (1st Dept. 2012) (#101535/09), is a reminder that partnership agreements, although not required to be in writing, should be in writing, so that there is at least a baseline for what the partners intended when the relationship sours.

The Claim

According to the amended complaint, in October 2007, Geoffrey Gelman, a Harvard graduate, and Antonio Buehler began working as partners to create an investment search firm. By the end of February 2008, when Gelman refused Buehler's demand for majority ownership of the partnership, Buehler withdrew from the partnership. The original complaint alleged eight causes of action and demanded millions of dollars in damages.

The Successful Motions to Dismiss

Defendant Gelman moved to dismiss and the plaintiff withdrew his claims for fraud, breach of fiduciary duty and negligent misrepresentation. In July 2009, Justice Barbara Kapnick dismissed the remaining claims and granted plaintiff leave to replead the claim for breach of the partnership agreement to set forth the terms of the partnership agreement that were allegedly breached.

Gelman filed an amended complaint, alleging breach of an oral partnership agreement to solicit investments for a "search fund" that would identify and then purchase a business in which the investments would later be monetized via a "liquidity event."

He alleged damages of $100,000 by virtue of the defendant's leaving the partnership prior to selling the business and paying back the investors, and also alleged damages of $600,000 for tortious interference.[1] The defendant again moved to dismiss on the grounds that the alleged partnership was terminable at will and had been terminated or, alternatively, that the claim was barred by the statute of frauds.

Once again, Kapnick agreed and dismissed the amended complaint with prejudice, relying on New York Partnership Law § 62(1)(b). That section provides that a partnership is lawfully dissolved "[b]y the express will of any partner when no definite term or particular undertaking is specified."

She held that "although it appears that the parties discussed various business plans and scenarios,

plaintiff has failed to allege sufficient facts or submit any evidence to support a finding that the partnership was for a definite term or a particular defined objective." Plaintiff appealed again, and the Appellate Division reversed, with two justices dissenting.

Reversal by the Appellate Division

Relying on Hooker Chemicals & Plastics Corp. v. International Minerals and Chemicals Corp., 90 A.D.2d 991 (4th Dept. 1982),[2] the First Department held that defendant could not legally unilaterally dissolve the partnership "since the partnership had the specific undertaking of acquiring a business and expanding it until the investors would receive a return on their capital investments.

Moreover, the partnership also had a definite term, namely, to achieve the liquidity event." Citing Haines v. City of New York, 41 N.Y.2d 769, 772 (1977), and Scholastic Inc. v. Harris, 259 F.3d 73, 85 (2d Cir. 2001),[3] it concluded that it was a question of fact for the jury whether a partnership is terminable at will and "what the parties intended if the agreement does not fix an express duration."[4]

Reversal by the Court of Appeals

The Court of Appeals reversed on the basis of the question that the Appellate Division certified: whether the allegations in the complaint "set forth a 'definite term' or identify the particular objective sought to be achieved with the requisite specificity."

The court discussed decisions in other jurisdictions interpreting the phrases "definite term" and "particular undertaking" used in Partnership Law § 62(1)(b). Based on those courts' interpretations, it concluded that the former "is intended to be durational in nature and refers to an identifiable termination date" and the latter "to require a specific objective or project that may be accomplished at some future time, although the precise date need not be known or ascertainable at the time the partnership is created."

Having decided on the meaning of the phrases, the court reversed because neither a definite term nor particular undertaking was sufficiently alleged. It held that the Appellate Division erred when it equated "definite term" with the liquidity event — "a possible future occurrence from which an identifiable termination date was not ascertainable at the outset of the partnership."

Rather than a definite term, the complaint alleged a "flexible temporal framework" and "lacks a fixed, express period of time during which the enterprise was expected to operate." Rather than a particular undertaking, the alleged sequence of anticipated partnership events were "too amorphous to meet the statutory 'particular undertaking' standard for precluding unilateral dissolution of a partnership." Therefore, the agreement at issue, "however well-intended, was dissolvable at will by either partner under Partnership Law § 62(1)(b)."

The Takeaway

We find the Appellate Division's reversal of defendant's motion to dismiss overly generous to plaintiff. However, ambiguity is never a good thing and certainly does not promote economy and efficiency. Steer clients away from oral agreements. Once dissension raises its head, at least with a written agreement the parties start on the same page.

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[1] Kapnick dismissed the tortious interference cause of action, and the Appellate Division affirmed.

[2] In Hooker, the Fourth Department reversed the lower court, which held on summary judgment in a declaratory judgment action that a joint venture agreement was terminable at the will of either party. The agreement provided that it would "continue without limitation as to time unless terminated" pursuant to several enumerated conditions. Several other agreements between the parties were annexed as exhibits to the joint venture agreement.

The Appellate Division held that (a) the court should have considered the other agreements in determining whether the parties provided for a definite term or specific undertaking; and (b) it was a question of fact whether the relationship was at will under Partnership Law § 62(1)(b). "Although the joint venture agreement provides that it will continue 'without limitation as to time,' a question of fact is presented as to whether the parties intended limitations other than time to determine the duration and whether the agreements when read together provide for a specific undertaking." 90 A.D.2d at 992.

[3] Haines involved a water treatment plant in Tannersville in upstate New York that the city of New York built in 1928, pursuant to a 1924 agreement, to prevent untreated sewage from entering the city's water supply system. The controversy arose in 1977 when a developer sought to build housing and the city refused permission because the plant was operating at full capacity and the city claimed that it had no obligation to further expand the plant. Both the trial and intermediate appellate court held that while the 1924 contract did not call for perpetual performance, the city was obligated to construct additional facilities to meet demand until such time as the locality was legally obligated to maintain a sewage disposal system.

The Court of Appeals rejected both plaintiffs' argument that the city was perpetually bound under the agreement, and the city's argument that it was terminable at will. In a ruling of first impression, the court held that "where the parties have not clearly expressed the duration of a contract, the courts will imply that they intended performance to continue for a reasonable time." The court expressly stated that this rule would not be applied to employment contracts, exclusive agency, distributorship or requirements contracts. It concluded: "[I]t is reasonable to infer from the circumstances of the 1924 agreement that the parties intended the city to maintain the sewage disposal facility until such time as the city no longer needed or desired the water, the purity of which the plant was designed to protect." However, the city had no obligation to extend the lines if to do so would overload the system. 41 N.Y.2d at 772-73.

[4] In Scholastic, the Second Circuit reversed the lower court's grant of summary judgment to defendant that his stock appreciation rights arising out of a joint venture agreement vested because the court found the agreement ambiguous. In the process, it engaged in a major discussion of New York partnership law.

With respect to Section 62(1)(b), citing Hooker, it held that whether a partnership is terminable at will is a fact question, and the jury should determine what the parties intended if the agreement does not fix

an express duration. Although leaning in the direction that the agreement at issue was terminable at will, and not for a fixed term or a particular undertaking, it held that on remand, the jury could take into account extrinsic evidence that might show that the parties did not intend for the venture to be terminable at will. 259 F.3d at 85-86.

[5] The court rejected defendant's alternative statute of frauds argument on two grounds: First, "although the estimated time to achieve a liquidity event was four to seven years, it cannot be said that there was absolutely no possibility that performance could not be completed within one year, ..." Second, it found partial performance in that the parties, inter alia, created marketing materials.
