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# Commercial division update: Reformation of contract based on mutual mistake

New York Law Journal

December 14, 2023 | By **Thomas J. Hall** and **Judith A. Archer**

**This column focuses on the first ground for seeking reformation, mutual mistake and addresses recent Commercial Division decisions that have struggled with that issue.**

Under New York law, reformation of contract is an equitable remedy allowing the court to rewrite a contract that does not accurately reflect the mutual intentions of the parties. Where the contracting parties agree to modify the contractual language, litigation is not needed. However, where the proposed reformed language benefits one party to the detriment of the other, litigation often ensues. To seek reformation of a contract, a party must show either a mutual mistake made by both parties or a unilateral mistake by one party caused by the fraudulent behavior of the other.

This column focuses on the first ground for seeking reformation, mutual mistake and addresses recent Commercial Division decisions that have struggled with that issue. A mutual mistake exists where the contractual language does not reflect the parties' meeting of the minds in some material respect. To prevail on a reformation claim based on mutual mistake, the party advancing the claim must prove a mutual mistake by both parties that resulted in either (1) an omission of an agreed upon provision or (2) the addition of a provision not agreed upon. *Slutzky v Gallati*, 97 A.D.2d 561, 561 (3d Dep't 1983).

As discussed below, determining whether a mutual mistake occurred to justify reformation is highly fact specific. The court will seek to determine the true intentions of the parties based on their contract negotiations, the circumstances surrounding those negotiations, the conduct of the parties post-execution, and whether the contract as written advances the parties' objectives in entering into the contract.

## Appellate precedent

The New York Court of Appeals has made clear that New York law's respect for the sanctity contract, particularly as between sophisticated parties, creates a high hurdle to proving the right to reformation based on mutual mistake.

In *Chimart Associates v. Paul*, 66 N.Y.2d 570 (1986), the court observed that the parol evidence rule, which bars evidence extrinsic to the four corners of a contract where the contract is unambiguous, is designed to protect against "the danger that a party, having agreed to a written contract that turns out to be disadvantageous, will falsely claim the existence of a different,

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oral contract." The court added that "freedom of contract would not long survive courts' ready remaking of contracts that parties have agreed upon."

As such, because "there is a 'heavy presumption that a deliberately prepared executed written instrument manifest[s] the intentions of the parties' . . . 'a corresponding high order of evidence is required to overcome that presumption.'" This means that "[t]he proponent of reformation must 'show in no uncertain terms, not only that mistake or fraud exists, but exactly what was really agreed upon between the parties.'"

Thus, to prove mutual mistake justifying reformation, clear and convincing evidence is required that the agreement does not adequately represent the intentions of both parties. *US Bank N.A. v. Lieberman*, 98 A.D.3d 422 (1st Dep't 2012). In addition to demonstrating the existence of mutual mistake at the time the contract was executed, the party seeking reformation must demonstrate that the mutual mistake was so substantial as to render the agreement not representative of a true meeting of the parties' minds. *Carney v. Carozza*, 16 A.D.3d 867, 868-69 (3d Dep't 2005).

## Commercial division application

In determining a mutual mistake reformation claim based on mutual mistake, New York's Commercial Division places considerable weight on the parties' negotiating history, among other factors.

In *Empery Asset Master v. AIT Therapeutics,* No. 651306/2018, 2021 BL 563359 (N.Y. Co. Sept. 1, 2020), *aff'd*, 197 A.D.3d 1064 (1st Dep't 2021), Justice Joel M. Cohen of the New York County Commercial Division held a bench trial on the issue of whether a single sentence, added to the contract late in the negotiations, created a contractual provision contrary to the parties' intentions so as to support a finding of mutual mistake.

The *Empery* plaintiffs held Warrants to purchase stock of AIT Therapeutics Inc. (AIT), which they were entitled to exercise in early 2018 at the exercise price set forth in the warrants. The warrants provided for reductions to that exercise price should certain events set forth in Section 3(b) thereof occur.

The first sentence of Section 3(b) provided that in the event, before the warrants were exercised, the company issued common stock at a price below the exercise price, the exercise price would be reduced to match. The second sentence of Section 3(b), added late in the negotiations, addressed a related scenario—in the event, before the warrants were exercised, the company issued common stock for no consideration (for example as part of employee compensation), the exercise price would be reduced to $0.01 per share.

It was the next sentence, the third in the final version of Section 3(b), that gave rise to the reformation claim. It provided in relevant part: "Upon each such adjustment of the Exercise Price pursuant to the immediately preceding *sentence*," then the number of warrant shares would increase based on the formula set forth therein.

The plaintiffs alleged that the mutual mistake was the use of the word "sentence" in that clause which, plaintiffs argued, was intended to read "sentences." Under plaintiffs' reformation argument, the parties' intent was to refer to the two immediately preceding "sentences." As executed, the number of warrant shares would be increased only where the company issued stock for no consideration (the second sentence of 3(b)), but plaintiffs argued the intent was to increase the warrant shares when either there had been a stock issuance at below the exercise price (based on the first sentence of 3(b)), or a stock issuance for no consideration (based on the second sentence of 3(b)).

Prior to plaintiffs exercising their warrants, the company had issued common stock at a price below the Warrant exercise price. As a result, AIT agreed that, under the first sentence of 3(b), this justified a reduction in the exercise price. However, AIT disagreed with plaintiffs that this also justified an increase in the number of warrant shares, asserting that the right to such an increase in the third sentence of 3(b) was triggered only by an issuance of stock for no consideration (the second sentence of 3(b)), which had not occurred.

In its post-trial ruling, the court agreed with plaintiffs and granted reformation. While that decision made dozens of factual findings, three facts may have been most influential to the court.

First, early on in the negotiations, the parties agreed that the warrants would have "full rachet anti-dilution protection," as confirmed by AIT's internal communications produced in discovery. The court found that such protection would involve both lowering the exercise price and increasing the number of warrant shares where the company had issued shares below the exercise price. Effectuating that intention of the parties required reformation of the word "sentence" in the third sentence to "sentences."

Second, the second sentence of Section 3(b) was not in the original draft at all. Rather, the final third sentence had been the second sentence, coming immediately after the first sentence. Thus, that early draft reflected an intention that the word "sentence" was a reference to the first sentence of 3(b).

Third, as to what the court called "the dog that didn't bark in the night," the court found not a single piece of contemporaneous evidence supporting AIT's view that the third sentence was meant to limit the increase in warrant shares protection only where the company had issued stock for no consideration.

In another New York County Commercial Division case, *Ralph Lauren Retail v. 888 Madison*, No. 652718/2021, 2022 BL 178101 (N.Y. Co. Apr. 25, 2022), *aff'd*, 213 A.D.3d 473 (1st Dep't 2023), Justice Barry R. Ostrager considered on a motion to dismiss whether the complaint sufficiently stated a claim for reformation based on mutual mistake.

Ralph Lauren Corporation (Ralph Lauren) was a long-term tenant of four floors at 888 Madison Avenue. The lease term ran to Aug. 31, 2027, with Ralph Lauren then having an option to renew it for another ten years until 2037. The lease required in the latter part of 2020 that the parties undergo a rent reset arbitration by which the rent for the third and fourth floors of the leased premises would be reset for the balance of the current lease term (until Aug. 31, 2027).

The complaint alleged that, in September 2020, during the COVID pandemic, the parties discussed agreeing to keep the rent for the leased third and fourth floors flat, which would avoid the need for the upcoming arbitration. The complaint then alleged that, in October 2020, the parties "unequivocally and clearly agreed" to keep the rent for those two floors flat for the remainder of the lease term without any extension of the lease term beyond the current expiration date of Aug. 31, 2027.

wHowever, when counsel for Ralph Lauren papered this agreement, he mistakenly included in the lease modification a provision that exercised Ralph Lauren's lease renewal right to extend the term from 2027 until 2037. Its complaint alleged that this error occurred "because during a significant change of their legal personnel, there was a communication error between their departing counsel (who had negotiated the modification) and their incoming counsel (who wrote it)."

In denying defendant's motion, the court found that the complaint's allegations of a mutual mistake in the lease modification, that it did not accurately reflect the parties' oral agreement, were adequate to avoid dismissal as the court was bound to accept the complaint's allegations as true.

In addition to the complaint's allegations, the court supported this conclusion with two other factors. First, although the landlord denied the existence of the oral agreement as alleged, the landlord's counsel conceded at oral argument that the parties had been negotiating a possible rent reduction due to the pandemic. Second, the court found somewhat illogical a conclusion that Ralph Lauren would have intentionally agreed in 2020, in the midst of the pandemic, to exercise a lease extension option seven years before the 2027 deadline for doing so.

The First Department affirmed, stating: "Where there is no mistake about the agreement and the only mistake alleged is in the reduction of that agreement to writing, such mistake of scrivener, or of either party, no matter how it occurred, may be corrected."

Conversely, in another case involving an alleged mutual mistake in a lease, Justice Joel M. Cohen of the New York County Commercial Division held in *A/R Retail v. Hugo Boss Retail*, 72 Misc. 3d 627, (N.Y. Co. 2021), that conclusory allegations of mutual mistake did not overcome the heavy presumption favoring enforcement of the unambiguous language in a lease. The court stated: "Reformation is not granted for the purpose of alleviating a hard or oppressive bargain . . . ."

The defendant-tenant alleged to be entitled to reformation of its 13-year commercial lease for its two-story Hugo Boss retail store with the plaintiff-landlord because of mutual mistake. Due to the COVID-19 pandemic, the landlord closed the defendant-tenant's premises as required by an Executive Order closing all "indoor common portions of retail shopping malls." Despite being deprived of possession, the lease required the tenant's continued payment of rent.

The tenant's counterclaims sought reformation of the lease "to reflect the parties' true intent that [tenant] would have no obligation to pay rent once it was deprived of its use of the premises and that the lease would terminate automatically when [tenant] was deprived of its use of the premises as originally contemplated by the lease."

In granting the landlord summary judgment dismissing tenant's claim, aside from finding the reformation claim time-barred, the court found that the tenant's proof was entirely too conclusory and speculative to support a reformation claim. It found that allegation to be at odds with lease provision that explicitly included an "unconditional obligation to pay rent" as well as a force majeure clause that "identifie[d] the risk of government closures but [did] not provide for relief from obligations to pay rent."

Unlike the *Ralph Lauren* case in which the tenant's specifically alleged the existence of an oral agreement that conflicted with the executed lease modification, the tenant here failed to support a reformation clause with any compelling extrinsic evidence to demonstrate that the lease did not reflect the actual agreement between the parties. As such, the court could look only to the four corners of the lease and general circumstances surrounding its execution, and dismissed the claim of mutual mistake.

## Conclusion

As demonstrated, courts will grant reformation of contract due to mutual mistake only when compelling evidence of the contrary intent of both parties is shown. It is important that the party seeking reformation point to a "high order" of evidence extraneous to the contract reflecting a mutual mistake in the executed contract. Otherwise, conclusory allegations of mistake may not survive a motion to dismiss, or a later summary judgment motion, and may face an uphill fight where the terms are clear and unambiguous in the executed contract.

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