

REAL ESTATE TRENDS

CONTRACTS

Are Inclusionary Air Rights Unique? Specific Performance Revisited

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On May 30, 2023, the Appellate Division, First Department, decided *301 East 60th Street LLC v. Competitive Solutions LLC*, 217 AD3d 79 (1st Dept. 2023) (*Competitive Solutions*)—the first decision to grant a purchaser of inclusionary air rights (IARs) the remedy of specific performance against a seller who reneged on the parties' agreement.

This article discusses two issues decided by the Appellate Division: (1) whether IARs are considered "unique," which is required to invoke the equitable remedy of specific performance, and (2) whether the parties' agreement entitled the purchaser to specific performance as a contractual remedy. (Disclosure: The prevailing purchaser in *Competitive Solutions*, 301 East 60th Street LLC ("purchaser"), was represented by Rosenberg & Estis.

Background

At the crux of *Competitive Solutions* was the nature of IARs. New York City grants IARs as an incentive for developers to build or rehabilitate affordable housing by awarding

those developers additional air rights, which can be used to increase the size of a development. However, unlike "ordinary" air rights that are appurtenant to specific real property and can only be used on that property or an adjacent property, IARs do not attach to the real property generating them.

It is therefore possible to purchase or own IARs without owning the property that generated them, although they must be used within the same Community District or within a half-mile radius of the property which generated them (see Zoning Resolution §23-96[a]).

IARs can be freely sold and transferred through private sale by obtaining a certificate of eligibility for zoning bonus (a "certificate") from the New York City Department of Housing Preservation and Development (HPD). There is limited market data concerning the transfer of IARs, since there are a limited number of transactions, and information about the sale prices of those transactions is not public or otherwise made easily available.

In *Competitive Solutions*, purchaser sought to acquire IARs for its development of five adjacent lots that it owned on the Upper East Side of Manhattan, located within Community Board 8. Accordingly, purchaser entered into a letter agreement (the "agreement") with seller to acquire 21,000 square feet of IARs for its intended development. Paragraph 8(b) of the agreement provided that, if purchaser was ready, willing, and able to purchase the IARs, and seller refused to transfer them "for any reason whatsoever," then:

Purchaser shall have the right, in its sole discretion as its sole and exclusive remedy, to either (a) seek specific performance of Seller's obligations under this Agreement or (b) terminate this Agreement by notice to Seller and cause

Escrow Agent to return the Deposit to Purchaser, together with any interest earned thereon.

(emphasis added).

Paragraph 8(b) further provided that:

In the event Purchaser shall not be successful in any action for specific performance, Purchaser shall still have the right to pursue the remedies...set forth in (b) above. Notwithstanding the foregoing, in the event that Seller's default hereunder is the result of HPD refusing the issue the Certificate due to circumstances that are beyond the reasonable control of Seller, then in such case, Purchaser's remedies hereunder shall be limited to the remedies set forth in (b) above.

After seller refused to close on the sale, purchaser commenced an action against seller seeking specific performance of the agreement, both as an equitable and contractual remedy. In response, seller asserted that purchaser had no right to specific performance under either theory.

The parties respectively moved for summary judgment, but Supreme Court denied both motions. Denying purchaser's motion, Supreme Court found that there were questions of fact as to whether IARs are "unique," which is required to invoke the equitable remedy of specific performance; and also found that a fair reading of the contract does not "guarantee" purchaser the right of specific performance.

Denying seller's motion, the court found that seller failed to demonstrate that the agreement does not entitle purchaser to specific performance. Both sides appealed to the Appellate Division.

Specific Performance as an Equitable Remedy

In New York, to obtain the equitable remedy of specific performance—a remedy external to the contract which compels the breaching party to perform the contract—the aggrieved party must show that (a) it performed its contractual obligations, (b) the defaulting party is able to perform its part, and (c) there is no adequate remedy at law (see *FMF Gen. Contr. Corp. v. Bisbee*, 6 AD3d 45 [1st Dept. 2004]).

The third prong of this test, that there is no "adequate remedy at law," exists where "the subject matter of the particular contract is unique" (*Sokoloff v. Harriman Ests. Dev. Corp.*, 96 NY2d 409 [2001]).

Seller sought to dismiss the complaint on the grounds that specific performance was not available to purchaser as an equitable remedy. Seller argued that (1) IARs are not

"unique" because IARs are not real property and are no different from other IARs that purchaser could obtain from another seller within Community Board 8; (2) because other "suitable substitutes" existed, similar to other goods that are capable of being duplicated, such as bricks, the particular IARs that seller owned could not be considered "unique"; and (3) since IARs were fungible assets that could be replaced, there is no irreparable harm, so money damages was the appropriate remedy.

Relying on the Court of Appeals landmark decision in *Van Wagner Adv. Corp. v. S & M Enters.*, 67 NY2d 186 (1986) (*Van Wagner*) and on *Stellar Sutton LLC v. Dushey*, 82 AD3d 485 (1st Dept. 2011), purchaser argued that the subject IARs were, in fact, "unique" because they were incapable of being valued with reasonable certainty, rendering money damages unavailable as an appropriate remedy.

In *Van Wagner*, the court determined that a "distinction must be drawn between physical difference and eco-

'Competitive Solutions' is a guidepost to parties engaged in any contractual dispute where specific performance might be sought as a remedy.

nomic interchangeability" (67 NY2d at 192), while noting that "uniqueness in the sense of physical difference does not itself dictate the propriety of equitable relief" (*id.*). With respect to whether a commodity can be valued with certainty and economic interchangeability, *Van Wagner* explained:

What matters, in measuring money damages, is the volume, refinement, and reliability of the available information about substitutes for the subject matter of the breached contract. When the relevant information is thin and unreliable, there is a substantial risk that an award of money damages will either exceed or fall short of the promisee's actual loss. Of course this risk can always be reduced—but only at great cost when reliable information is difficult to obtain. Conversely, when there is a great deal of consumer behavior generating abundant and highly dependable information about substitutes, the risk of error in measuring the promisee's loss may be reduced at much smaller cost. In asserting that the subject matter of a particular contract is unique and has no established market value, a

court is really saying that it cannot obtain, at reasonable cost, enough information about substitutes to permit it to calculate an award of money damages without imposing an unacceptably high risk of undercompensation on the injured promisee. Conceived in this way, the uniqueness test seems economically sound

(id. at 193 [internal citations omitted]).

Purchaser argued that, because IARs are so thinly and opaquely traded, the market value of the IARs could not be reasonably obtained, noting that seller's principal himself, who was an expert in IARs, admitted that he could not ascertain the market value of the IARs that seller had initially agreed to sell to purchaser. Under *Van Wagner*, the IARs were, therefore, "unique."

Specific Performance as a Contractual Remedy

In the alternative, purchaser argued that it was entitled to specific performance as a contractual remedy, noting that the contractual prerequisites for specific performance under the agreement had been satisfied. Accordingly, relying on *101123 LLC v. Solis Realty LLC*, 23 AD3d 107 (1st Dept 2005) ("*Solis*"), purchaser argued that specific performance should be awarded as a contracted-for enforcement mechanism under the agreement, if not as an equitable remedy extraneous to it.

In *Solis*, the court held that parties are free to establish in a contract the prerequisites for obtaining the remedy of specific performance in the event of a breach. The default provision in *Solis* provided that the "Purchaser shall have the right to bring an action for specific performance against seller and exercise any other remedies at law or in equity" if the seller willfully defaulted (id. at 108-109).

Affirming the trial court's granting of specific performance in *Solis*, the First Department ruled that:

Where the parties to a real property sale contract have made specific provision for the buyer's options in the event the seller is unable to satisfy a condition in the contract, and have even agreed upon the circumstances under which the buyer may claim a right to specific performance of the contract, the [principles of contract law] require the court to enforce the contract as written, including the applicable remedies, and the court may not look beyond the agreed-upon remedies to award the buyer specific performance in circumstances other than those in which the parties agreed that it would be available.

(id. at 112-113).

Purchaser argued that a contract freely entered into between two sophisticated parties that provided for the remedy of specific performance should be enforced as written, in the absence of countervailing public policy. Because purchaser satisfied the conditions stated in the agreement to seek specific performance, it should be awarded as a contractual right.

Seller argued that New York does not recognize a contractual right of specific performance. Rather, the agreement makes clear that purchaser's sole and exclusive remedy was to either "seek" specific performance or pursue the return of deposit.

Seller asserted that the word "seek" was used intentionally to incorporate the common law, equitable test for spe-

The 'Competitive Solutions' court established that IARs are to be considered "unique" for purposes of awarding specific performance, in equity, against a defaulting seller, which will provide greater certainty for purchasers engaging in similar transactions.

cific performance, which does not provide purchaser with the contractual right to receive specific performance.

It was seller's position that the agreement merely provided purchaser with the right to "seek" specific performance, not "receive" it, and that the agreement contemplated circumstances when specific performance would not be awarded, in recognition of the fact that purchaser might not be successful in "seeking" specific performance.

Seller further noted that the agreement did not contain recitals that might supplant the common law test and support a contractual right to specific performance, such as stating that a default would cause purchaser to suffer irreparable harm, that purchaser's damages cannot be calculated with reasonable certainty, or that the IARs are irreplaceable or unique. Accordingly, seller argued, specific performance was not a contractually "guaranteed" remedy.

Purchaser argued that seller's interpretation of the agreement could not be correct under settled law concerning contract interpretation. If, as seller asserted, specific performance

was not available as a contractual remedy, because it can never be a remedy at law, and it was not available as an equitable remedy, because IARs are not unique, then purchaser's right to "seek" specific performance could never succeed.

In seller's view, the default provision was void *ab initio*, without force or effect, and mere surplusage, which violates cardinal principles of contract interpretation requiring that no provision in a contract can be interpreted as being without meaning.

The Appellate Division's Ruling

The Appellate Division agreed with purchaser, finding that seller's interpretation of the agreement was "unpersuasive," particularly because under seller's interpretation of the agreement, there was no situation where purchaser could succeed in an action for specific performance.

The court found that merely including the term "seek" in an agreement does not create a barrier to contractual relief. Instead, the court must enforce a contract that provides for specific performance according to its terms and should accord deference to the parties' "manifest intent," unless it would result in an inequitable result. Here, since the criteria in the agreement for specific performance were met, specific performance was an available remedy.

However, the Appellate Division made clear that there is no automatic contractual right to specific performance; it is an equitable remedy for a breach of contract. It is a matter of judicial discretion that is controlled by doctrines and principles of equity.

Therefore, the Appellate Division explained, courts must balance "the expectation interest of the injured party" against whether specific performance would impose a disproportionate or inequitable burden on the breaching party.

Here, seller did not argue that specific performance of the contract would impose a disproportionate or inequitable burden, and instead argued that purchaser was not entitled to specific performance because seller claimed that returning purchaser's deposit was an adequate remedy for breach of the agreement to convey the IARs.

The Appellate Division disagreed with seller and stressed that a parties' wish to simply return a deposit, and unwilling-

ness to perform its contractual obligations, does not furnish a defense to specific performance, nor grounds to cancel a contract.

The Appellate Division explained that, in New York, courts consistently consider air rights to be "an interest in real property," which weighs in favor of granting specific performance. However, the court also emphasized that specific performance is not limited to real property, and applies in other instances, such as the sale of shares of stock in a close corporation or an agreement to sell shares in a cooperative, neither of which are real property rights.

The court further explained that specific performance may also be available in actions "where the market is opaque and the price of the goods is subject to intense fluctuation." Here, seller admitted that it was difficult to ascertain the value of IARs due to the lack of documentation.

Therefore, the Appellate Division found that, in *Competitive Solutions*, specific performance of the agreement to sell the IARs was warranted because of the parties' express incorporation of a specific performance remedy in their agreement, seller's willful breach of the agreement, the absence of an inequitable or disproportionate burden against seller, and the admitted uncertainty of valuing the IARs.

The *Competitive Solutions* court established that IARs are to be considered "unique" for purposes of awarding specific performance, in equity, against a defaulting seller, which will provide greater certainty for purchasers engaging in similar transactions. However, it should remind practitioners that New York does not automatically recognize a contractual right to specific performance.

Any party seeking or defending against claims for specific performance, or involved in drafting or entering to a contract for the sale of goods, real property, or related items of value should consider this well-reasoned decision illuminating the elements and considerations that courts will weigh and consider to determine whether to grant a claim for specific performance. *Competitive Solutions* is a guidepost to parties engaged in any contractual dispute where specific performance might be sought as a remedy.