New York Law Journal: Court Of Appeals Upholds Enforcement Of Oral Contract For 'Guaranteed Bonus'

May 18, 2012 • Legal Updates & Insights

Recently, in *Ryan v. Kellogg*, the New York Court of Appeals upheld, after trial and an affirmance (with two dissents) by the First Department, the enforcement of an oral contract between a financial services employee and his employer for what the employee referred to as A guaranteed bonus. *Kellogg* joins the line of recent cases in scaling back the protection afforded employers who deny payment of bonuses to employees in the wake of the New York Court of Appeals case *Truelove v. Northeast Capital & Advisory*. Particularly, *Kellogg* holds that the employer is responsible for the payment of a bonus to a former employee, further demonstrating that the right of employers to be protected from liability is not absolute even where an employee application and handbook contain employment-at-will language.

Suit Over Bonus

Plaintiff Daniel Ryan was approached by the managing partner of Kellogg Partners Institutional Services, LLC about the possibility of becoming head floor broker at Kellogg in early 2003.3 At the time, Ryan was working for an established brokerage firm where he earned $270,000 the previous year. Ryan testified that he agreed to change jobs to work for the start-up Kellogg only if the managing partner agreed to a package of $350,000. According to Ryan, the managing partner agreed to provide a package of

$350,000 if the compensation for the calendar year could be split into a $175,000 salary and a guaranteed bonus of $175,000. After this conversation, Ryan signed an employment application with Kellogg that acknowledged an at-will termination provision. Ryan also signed an acknowledgement of receipt of the employee handbook which included a similar at-will employment provision.

Ryan began working as the head floor broker at Kellogg on July 14, 2003. By February 2004, Ryan still had not received the agreed- upon bonus. According to Ryan, the managing partner asked Ryan to forgo the bonus for a year, and accept it for work in 2004 instead. Ryan agreed to this new set of terms. By early 2005, however, Ryan had still not received the agreed-upon bonus. Finally, in February the managing partner offered Ryan a $20,000 bonus for work performed in 2004. Ryan rejected the lesser bonus and was fired five days later. The managing partner cited insubordination and disparaging the employer as the reason for termination.

Ryan filed a complaint on May 26, 2005, alleging causes of action for failure to pay wages in violation of Labor Law §§190-198 and breach of contract. Defendant, relying on the handbook and employee application, argued that bonuses were discretionary only. At trial, the jury unanimously determined that Kellogg had breached an oral agreement to pay Ryan a guaranteed bonus of $175,000. The jury also determined, however, that Kellogg had not willfully withheld this payment, preventing Ryan from receiving liquidated damages.

Both parties moved for a judgment notwithstanding the verdict on their respective claims. Kellogg claimed that the alleged oral agreement was unenforceable in light of the statute of frauds included in the General Obligations Law. Ryan believed that he presented enough evidence of a willful violation of the Labor Law. The Supreme Court affirmed the ruling of the trial court and further decided that Kellogg had waived any rights to plead any provisions of the General Obligations Laws by failing to plead them as affirmative defenses. The Supreme Court also decided that the jury was entitled to believe that Kellogg did not refuse to pay the bonus maliciously. The Supreme Court awarded Ryan the total sum of $379,956.65, consisting of the agreed-upon bonus, statutory interest, and attorney fees.

The Appellate Division affirmed and Kellogg appealed to the Court of Appeals. The Court of Appeals primarily ruled upon the issue of whether the job offer included a guaranteed bonus of $175,000. First, the court dismissed Kellogg's argument that the employment application and employee handbook signed by Ryan precluded any entitlement to a guaranteed bonus. The court noted that while Ryan signed these documents, neither the application nor the handbook included statements that bar Ryan's recovery on his breach of contract and Labor Law claims. These documents referred to the right to continued employment, compensation, and benefits from Kellogg, a right Ryan never asserted.

Next, the court affirmed that Kellogg waived its right to raise defenses to Ryan's claims under the General Obligations Laws. The court, however, proceeded to discuss the merits of these arguments as well. Kellogg argued that under the statute of frauds included in the General Obligations Laws, certain kinds of agreements must have been expressed in writing in order to be enforceable. These agreements include agreements that are incapable of being performed within a year of their making; agreements made without consideration to change an existing contract; and agreements based on past consideration. The court held that the oral agreements between Kellogg and Ryan did not fit into any of these categories.

Lastly, the court held that Kellogg's neglect to pay Ryan his bonus violated Labor Law §193, thereby entitling Ryan to an award of attorney fees. Ultimately, the Court of Appeals affirmed the order of the Appellate Division.

Earlier Decision

The opinion of the Court of Appeals in *Kellogg* rested upon distinctions made from the earlier decision of the court in *Truelove*. In *Truelove*, the plaintiff brought action against his former employer under Article 6 of the Labor Law to recover the unpaid balance of a bonus he was awarded.4 The bonus was made payable in quarterly installments throughout the following year. The plaintiff argued that his bonus constituted wages and that his employer violated Labor Law by not continuing payment of his bonus after his resignation.

The Court of Appeals, however, held that the plaintiff's bonus did not fall within the definition of wages pursuant to Labor Law Article 6. Article 6 defines wages as "the earnings of an employee for labor or services rendered, regardless of whether the amount of earnings is determined on a time, piece, commission or other basis." This definition was meant to exclude types of incentive compensation. The court reasoned that the bonus compensation plan was "not predicate[d] upon plaintiff's own personal productivity nor [gave] plaintiff a contractual right to bonus payments based upon his productivity." The

court also noted that “plaintiff’s share in the bonus pool was entirely discretionary and subject to the non-reviewable determination of his employer.” These factors pushed the bonus outside of the realm of the wages covered under the statute.

Thus, *Truelove* was a decision that protected employers from the claims of employees. Specifically, employers were allowed to reject the vested interest of an employee in a bonus, even after declaring that a bonus would be paid and calculating the amount of that bonus. Employers appeared to be given unfettered discretion of whether to actually award a bonus to an employee or not.

New York courts began to scale back the decision in *Truelove* with *Fiorenti v. Central Emergency Physicians*,5 by clarifying the degree of discretion of employers over bonuses. In *Fiorenti*, the plaintiffs alleged a violation of the Labor Law claiming that their employer withheld their wages by not paying bonuses due for three separate years. Defendants astutely relied on *Truelove* to argue that the bonus provision included in the agreement with their employees constituted an incentive compensation plan dependent upon the profitability of the employer and not the productivity of the employee.

The Supreme Court, Nassau County, however, decided that the employees at issue had a right to a bonus pursuant to Article 6 of the Labor Law. Specifically, the court reasoned that a compensation scheme which is “predicated upon an employee’s personal productivity and the objective success of the venture—not the employer’s discretion or any subjective standard—is a contractual right of the employee.” Thus, when the compensation scheme for a bonus applies an objective standard and is not subject to an employer’s “whim,” the employee has a right to the bonus.

Another significant departure from *Truelove* came in *Wachter v. Kim*.6 In *Wachter*, the plaintiff was hired to serve as a managing director and general counsel of a limited partnership. The employment contract included a provision that the plaintiff would receive no less than $2 million for the calendar year. The contract further provided that any bonus to be made to the plaintiff would be in

the sole discretion of the limited partnership. When the venture collapsed and the defendant informed all of the employees that they would no longer be needed, the plaintiff sued under the Labor Law for unpaid wages. The court in *Wachter* recognized that the

Labor Law does not consider discretionary additional funds, such as bonuses, to be wages under the statute. The court reasoned that the language of the employment contract, however, overrode the discretionary nature of the bonus by stating that the plaintiff shall receive no less than $2 million in the calendar year. Therefore, the defendant was required to make up for any shortfall of the plaintiff’s guaranteed salary with bonus compensation. The *Wachter* decision further emphasized that the employer’s right to not pay bonus compensation is not absolute.

The most recent blow to *Truelove* came in *Kellogg*. Defendant Kellogg cited *Truelove* to support the argument that Ryan’s bonus was discretionary, did not amount to wages under Labor Law, and, as such, he should not be entitled to an award including attorney fees.7 The court, however, dismissed Kellogg’s reliance on *Truelove* and distinguished the facts of the two cases. According to the Court, “Ryan’s bonus was expressly linked to his labor or services personally rendered.” Based on the oral agreement believed by the jury, Ryan made the $175,000 bonus a condition of his accepting a job. Kellogg did not retain any

discretion over the bonus. Furthermore, the bonus was not conditioned upon the success of the business. Ryan's bonus was entirely based on his work as a floor broker.

The court further reasoned that Ryan's bonus had already become a vested interest before he left his job at Kellogg. Bonus payments that are already due before the employment ends fall under the definition of wages in §190. The original oral agreement for $175,000 was meant to be paid out in late 2003 or early 2004. Then, Ryan agreed to modify the oral agreement to receive the bonus in late 2004 or early 2005 for his continued work at Kellogg throughout that period. In early 2005, Kellogg had still not paid the bonus, which had already vested by that point. Ryan's employment did not end until February 2005, after the bonus payment by Kellogg had already become due. Ultimately, with this decision, another chink was made in the absolute armor of employers.

Impact of 'Kellogg'

The importance of *Kellogg*, in conjunction with *Truelove* and *Fiorenti*, thus lies in the guidance it provides to the employment agreement context. Specifically, these cases underscore the importance of having clear and definite offer letters, employment agreements, and/or terms for avoiding bonus compensation for both the employer and the employee. Employees should look for an employment agreement that clearly defines the compensation scheme, including how much the bonus will be and when that bonus is due. Employees should seek language in a bonus provision of an employment contract that places the bonus beyond the whim and discretion of the employer, and provides for the bonus to be paid for upon a termination "without cause" or if the employee leaves for "good reason."

On the flip side, employers should always ensure that they have written terms that clearly define the terms of any discretionary or mandatory bonus. When the agreement is oral, the issue will ultimately come down to which party the jury decides to believe, as seen in *Kellogg*. Employers seeking to make bonuses entirely discretionary should include language in the terms of employment that retains an element of control over the bonus. For instance, the terms could make bonuses contingent upon the overall success of the business.8 The terms could also condition the payment of a bonus upon continued employment.9 Moreover, the terms could simply state that any bonus compensation is purely within the discretion of the managing body.

As New York courts continue to address the issue of discretionary and nondiscretionary compensation schemes, employers and employees will receive more guidance as to how to tailor their agreements to each party's own benefit. With this most recent *Kellogg* decision, however, New York courts have certainly made it clear to employers that the right to avoid liability for denying bonus compensation is no longer an absolute right.

Douglas H. Wigdor *is a founding partner of Thompson Wigdor.* **Jamarri Ivy**, *an associate at the firm, assisted in the preparation of this article.*

Douglas H. Wigdor
Partner
WIGDOR LLP
85 Fifth Avenue, New York, NY 10003
T: (212) 257-6800 | F: (212) 257-6845

dwigdor@wigdorlaw.com
wigdorlaw.com